Supreme Court, U. S.
FILED
JUN 2 1978
RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1977

No. 77-1725

COLECO INDUSTRIES, INC.,

Petitioner,

ABE BERMAN, JOSEPH RUBIN, IRVING COHEN, LEWIS M. COHEN, FREDERICK COHEN, ZELNICK, SOBELMAN & COMPANY,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

JOSEPH A. YABLONSKI
DANIEL B. EDELMAN

Yablonski, Both & Edelman
1150 Connecticut Avenue, NW
Suite 500
Washington, DC 20036

Attorneys for Coleco Industries, Inc.

THE CASILLAS PRESS, INC.–1717 K Street, N. W.–Washington, D. C.–223-1220

TABLE OF CONTENTS

Page

OPINIONS BELOW 1

JURISDICTION 2

QUESTION PRESENTED 2

STATUTES INVOLVED 2

STATEMENT OF THE CASE 2

A. The Pretrial Period 3

B. The District Court's Preclusion Ruling and Opinion 7

C. The Court of Appeals Opinion 9

REASONS FOR GRANTING THE WRIT

THIS COURT SHOULD EXERCISE ITS CERTIORARI POWER TO RESTORE THE PRETRIAL PROCESS TO THE FORM INTENDED BY RULE 16, F.R.C.P. AND TO RESOLVE THE CONFLICT AMONG THE CIRCUITS REGARDING THE PRECLUSION OF EVIDENCE NOT SPECIFIED IN A PRETRIAL MEMORANDUM 10

CONCLUSION 17

TABLE OF AUTHORITIES

Page

Cases

Dudley v. South Jersey Metal, Inc.,
555 F.2d 96 (C.A. 3, 1977). 9

Foman v. Davis,
371 U.S. 178 (1962) 14

Jones v. Union Automobile Indemnity Ass'n.,
287 F.2d 27 (C.A. 10, 1961) 11

McCargo v. Hedrick,
545 F.2d 393 (C.A. 4, 1976) 13, 15, 16

Meyers v. Pennypack Woods Home Ownership Ass'n.,
559 F.2d 894 (C.A. 3, 1977) 9

Padovani v. Bruchhausen,
293 F.2d 546 (C.A. 2, 1961) 17

Peter Eckrich & Sons, Inc. v. Selected Meat Co.,
512 F.2d 1158 (C.A. 7, 1975) 15

Schlagenhauf v. Holder,
379 U.S. 104 (1964) 13, 14

Societe Internationale v. Rogers,
357 U.S. 197 (1958) 14

Statutes and Rules

Federal Rules of Civil Procedure,
Rule 16 . . . . . 2, 5, 9, 10, 11, 13, 15, 16, 17

Local Rules for the United States District Court for the Eastern District of Pennsylvania

Rule 7 . . . . . 2, 3, 4, 5, 9
Rule 7(f) 5

Page

United States Judicial Code, 28 U.S.C.
§ 1254(1) 2

Miscellaneous

Burger, *Address to the National Conference on the Causes of Popular Dissatisfaction with the Administration of Justice*, 70 F.R.D. 79 (1976) 12, 13

Clark, *Seminar on Procedures for Effective Judicial Administration*, 29 F.R.D. 191 (1961) 12

Pollack, *Pretrial Procedures More Effectively Handled*, 65 F.R.D. 475 (1975) 12, 13

Wright, *Address to the Judicial Conference of the Tenth Circuit*, as quoted in Pollack, *Pretrial Conferences, An Address to the Judicial Conference of the Eighth Judicial Circuit of the United States*, 50 F.R.D. 427 (1970) 13

Dobie, *The Federal Rules of Civil Procedure* 25
VA. L.Rev. 261 (1939). 11

IN THE

Supreme Court of the United States

October Term, 1977

No. _____

COLECO INDUSTRIES, INC.,

Petitioner,

ABE BERMAN, JOSEPH RUBIN, IRVING COHEN, LEWIS M. COHEN, FREDERICK COHEN, ZELNICK, SOBELMAN & COMPANY,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The Petitioner, Coleco Industries, Inc. respectfully prays that a Writ of Certiorari issue to review the decision of the United States Court of Appeals for the Third Circuit entered in this proceeding on November 25, 1977.

OPINIONS BELOW

The Opinion of the United States Court of Appeals for the Third Circuit is officially reported at 567 F.2d 569. It is appended to this Petition as Appendix A (1a-18a).

The Opinion and Order of the United States District Court for the Eastern District of Pennsylvania is reported at

423 F.Supp. 275 and is appended to this Petition as Appendix B (19a-145a).

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1). The decision of the United States Court of Appeals was entered on November 25, 1977. A timely filed petition for rehearing and suggestion for rehearing *en banc* was denied on January 6, 1978. By orders dated March 28, 1978 and April 26, 1978, Mr. Justice Brennan extended the time for filing this Petition to and including June 5, 1978.

QUESTION PRESENTED

The issue presented is whether precluding a party from submitting evidence which the Court later finds "critical" to its claim can be justified where the trial court has not entered a pre-trial order pursuant to Rule 16 and the party precluded has made massive pre-trial filings describing its anticipated proof.

STATUTES INVOLVED

This Petition involves Rule 16 of the Federal Rules of Civil Procedure and Local Rule 7 of the Rules of the United States District Court for the Eastern District of Pennsylvania which are appended as Appendix C (143a, 144a-154a).

STATEMENT OF THE CASE

This action arises from a 1973 Agreement by Coleco Industries, Inc. ("Coleco") to purchase a swimming pool manufacturing company, Royal All-Aluminum Swimming Pools, Inc. ("Royal") from Royal's shareholders, Abe Berman, Joseph Rubin and the Cohen brothers, Respondents

herein. The selling price included $500,000, to be paid in three annual installments, and additional, contingent payments based upon Royal's after-tax earnings in the three years following acquisition.

Within six months after the acquisition, Royal failed. In December, 1973, Coleco filed suit against the selling shareholders and Royal's accountant, Zelnick, Sobelman & Company. Claiming, among other things, a material breach of the Purchase Agreement, Coleco sought to recover its first installment payment of $135,000 and more than $800,000 in additional damages, representing Coleco's out-of-pocket losses in Royal. Respondents counterclaimed and sought damages *inter alia* for the balance of the Purchase Price — $365,000, plus interest from the date of purchase. In defending the contract counterclaim, Coleco maintained that the materiality of Respondents' contract breach relieved it of any further obligation to pay the balance of the non-contingent purchase price. Thus, materiality of Respondents' breach was critical, not just to the prosecution of Coleco's claims, but to its defense as well.

A. The Pretrial Period.

In the eighteen months after suit was filed, the parties engaged in extensive discovery, including voluminous depositions, interrogatories and requests for documentary production. By any yardstick, the case was massive and complex. On July 31, 1975, the district court entered an order requiring the completion of the discovery by October 1, 1975, setting a final pre-trial conference for late October and a trial date of November 10, 1975. One week later, the Court entered a lengthy "form" order directing the filing of "final Pretrial Briefs." At that time, Rule 7 of the Local Rules for the United States District Court for the Eastern District of Pennsylvania outlined the items to be included in a pre-trial memorandum, but permitted each Judge to establish his own requirements:

"(a) . . . Unless otherwise determined by the judge such pre-trial memorandum shall contain the following:

(1) A *brief* summary of both the facts of the case and counsel's contentions as to the liability of defendant. . . ."

(2) A *brief* description of the damages claimed and the basis thereof. . . .

* * *

(b) Except for witnesses called on rebuttal or surrebuttal, a witness neither (1) named in any pre-trial memorandum or supplements thereto of any party, nor (2) authorized by the court in order to prevent manifest injustice, may not testify at the trial if timely objection is made by opposing counsel.

(c) The judge to whom the case is assigned may require more or less elaborate pre-trial memoranda and may publish his own standing order with respect to the manner in which he intends to hold pre-trial conferences and his requirements of counsel in respect of pre-trial procedures." (144a-145a) (Emphasis supplied).

Judge Huyett's order did not contemplate the brevity suggested by the Local Rules; rather, his order directed "plaintiff" to file a Final Pretrial Brief ". . . which shall not thereafter be amended or supplemented and shall contain in the following order:"

"(a) Proposed stipulations of specific facts framed for reading to the jury;

(b) Plaintiff's contentions on specific disputed facts;

(c) Plaintiff's contentions on the principal specific issues of law;

(d) Plaintiff's final designation of witnesses to be called at trial, listed in the order in which they will be called and briefly identifying each witness and specifying the evidence which the witnesses will give;

(e) Plaintiff's final designation of the specific portions of deposition testimony which they will offer in evidence at the trial;

(f) Plaintiff's designation of specific answers to interrogatories which they will offer in evidence at trial;

(g) Plaintiff's designation of the specific documents which they will introduce at the trial;

(h) Requests for instructions to the jury;

(i) Proposed special interrogatories to the jury."

Neither the Local Rule nor Judge Huyett's order stated that evidence of specific facts not included in the memoranda would be precluded at trial.[1] On October 28, 1975, in compliance with Judge Huyett's order, Coleco filed a massive Pretrial Brief, 157 pages in length and containing a total of

[1]The Local Rules were amended after trial, but before a decision was rendered. The Local Rules, as amended, are reproduced in Appendix C (146a-154a). The amended rules set forth four pages of items to be included in each party's pre-trial memorandum (150a-153a), require a pre-pre-trial conference among counsel, and provide that the pre-trial order will be written by the parties and only signed by the Court, all of which are contrary to the letter and spirit of Rule 16, F.R.C.P. See pp. 12, 15-16, *infra*.

715 paragraphs of proposed stipulations, factual and legal contentions and lists of documents and witnesses.

The core of Coleco's contract claim was that Royal's profit and loss statement, warranted as accurate by the selling shareholders, overstated gross profits as 35% rather than 14%. To support its claim, Coleco planned to show that Royal's financial statements understated the cost of goods sold during the quarter immediately preceding acquisition by $130,000. Two errors which accounted for approximately $50,000 of the understatement were essentially undisputed and were ultimately conceded. Coleco contended that the remaining discrepancy of $80,000 occurred because the constituent pool parts had actually cost more than indicated by the warranted statements.

Believing Royal's actual costs to be undisputed, Coleco moved for partial summary judgment on its contract claim more than one month before trial, appending an affidavit and invoices for goods purchased by Royal during 1973. The summary judgment motion was not argued until November 3, 1975, one week before trial was to begin. At that hearing Respondents resisted summary judgment, arguing for the first time, as the district court later acknowledged (85a-86a & n.46), that because Royal utilized First-In, First-Out accounting, Coleco should have shown the costs of goods purchased in 1972 which remained in inventory at the beginning of the accounting period in question. (85a-86a & n.46). In other words, Respondents argued that Coleco could prove the additional $80,000 error only through 1972 invoices and not through the 1973 invoices as Coleco had done in its summary judgment motion and appended affidavit and exhibits.

Preparation for trial proceeded while the motion was *sub judice*. A pre-trial conference was held in late October. No pre-trial order was entered in any way limiting the evidence to be presented at trial.

B. The District Court's Preclusion Ruling and Opinion.

Coleco's Motion for Summary Judgment was denied on the first day of trial, thereby highlighting the importance to Coleco of proving that 1972 costs were at least equivalent to those in 1973. Accordingly, Coleco undertook a comparison of Royal's 1972 and 1973 invoices. In the second week of trial,[2] Coleco called F. James Hubert, its Controller, to prove errors in the Profit and Loss Statement including the errors of undercosting.

Counsel for Respondents were permitted to take a "dry run" of Hubert's testimony outside the hearing of the jury during which Hubert testified that he determined that the actual cost of pools was much higher than represented by the accounting papers based upon his review of the 1973 invoices (Tr. 1152). On cross-examination by counsel for the Cohens, with the jury not present, Hubert stated that he had also reviewed the 1972 invoices (Tr. 1166-67); and on redirect, he testified that the 1972 costs were, if anything, higher than 1973 costs (Tr. 1168-69). Before Hubert resumed his testimony involving costs before the jury, Judge Huyett permitted his deposition to be taken by Respondents during the evening recess (Tr. 1178-1182A).

When Hubert took the stand before the jury, the Court, over Coleco's objection, precluded Coleco from offering evidence regarding 1972 costs stating that such evidence was not listed in its Pretrial Brief and that admission of such evidence would unduly prejudice the Respondents. The Court stated that Coleco had not sought to amend its pretrial memorandum. Neither the Court nor Respondents' counsel could then — nor at any time since then — point to any paragraph or even a phrase in Coleco's pretrial

[2]Ultimately the trial lasted thirty-four days. It began as a jury trial, but at mid-point, all parties agreed to dismiss the jury and try the case to the Court.

memorandum which necessitated any amendment.[3] Nothing in Coleco's submission required amendment or modification because Coleco did not state in its pre-trial memorandum *how* it would prove the $80,000 undercosting error. Rather, its memorandum stated that the quarterly financial statement preceding acquisition overstated inventory and understated costs of goods sold by a total of $130,000 which included the undisputed errors of $17,372.88 and $32,550. No specific documents were relied upon or listed as supportive of the remaining $80,000 undercosting error. Coleco did, however, identify in its pre-trial memorandum — in a list ten pages long — various documents which might be introduced at trial including both the 1972 and 1973 invoices.[4] Thus, even if the Petitioner's own pre-trial memorandum somehow acquired the force and effect of an order, there was nothing in the memorandum which was misleading or required amendment.

In its Opinion and Order, the District Court acknowledged that the "blow" dealt to Coleco by the preclusion ruling was fatal to Coleco's attempt to prove the $80,000 undercosting error (86a & n. n. 46). By preventing Coleco from establishing the materiality of Respondent's breach, the ruling deprived Coleco both of its contract

[3]The error committed by the Court in excluding this evidence was, in Coleco's view, compounded when, following cross-examination of Hubert regarding statements contained in his summary judgment affidavit to the effect that he was then relying upon 1973 invoices, the Court prohibited Coleco from rehabilitating Hubert on redirect by showing that the 1972 costs were equal or more than 1973 costs. (Tr. 1435-1438).

[4]Because of its length and the numerous subjects required to be included by the Court's order, Coleco's Pre-Trial Memorandum was not consecutively paginated. References in the text are to the parts of the Memorandum entitled "April 30, 1973 Financial Statement," paragraphs 11, 12, 17-19, and a section entitled "Documents," paragraph 16 (ee) and (ff).

damages for material breach and its defense of material breach to Respondents' counterclaims, which uitimately resulted in an over-all loss to Coleco of more than one-half million dollars. (110a-111a, 140a-141a).

C. The Court of Appeals Opinion.

In its opinion, disposing of the various issues raised by Coleco and Respondents in their cross-appeals (3a-18a), the Third Circuit affirmed the preclusion ruling. Acknowledging that Judge Huyett's ruling had "drastic" consequences for Coleco and noting that "two recent decisions of this Court have applied relatively strict scrutiny for abuse of discretion in cases of evidentiary exclusions" (13a & n.14),[5] the Court, nevertheless, found "no excuse" presented for Coleco's "failure to advise the Court earlier that the evidence would be offered. . . ." (12a-13a). (The Court was aware that Coleco did not even have reason to check the 1972 invoices until the issue was first raised at the summary judgment argument, a week before trial). The Court of Appeals, without reference to Rule 16, F.R.C.P., found that the Local Rule in effect at the time of trial — Local Rule 7 — "made no explicit provision for a pretrial order, and indeed contemplated the required pretrial memorandum [submitted by each party] as having preclusive effect, at least as to witnesses." (12a & n.13).

"Most importantly", the panel decision found that the pretrial order issued by Judge Huyett required "Plaintiffs' final designation of witnesses to be called at trial . . . briefly identifying each witness and specifying the evidence which the witnesses will give." (12a) The Third Circuit held that "given this order" it could not conclude that it was "an

[5]*Meyers v. Pennypack Woods Home Ownership Assn.*, 559 F.2d 894 (C.A. 3, 1977); *Dudley v. South Jersey Metal, Inc.*, 555 F.2d 96 (C.A. 3, 1977).

abuse of discretion to prevent the plaintiffs [sic] from introducing a study of 1972 invoices which they [sic] neglected to mention before its introduction at trial." (12a & n.13)

REASONS FOR GRANTING THE WRIT

THIS COURT SHOULD EXERCISE ITS CERTIORARI POWER TO RESTORE THE PRETRIAL PROCESS TO THE FORM INTENDED BY RULE 16, F.R.C.P. AND TO RESOLVE THE CONFLICT AMONG THE CIRCUITS REGARDING THE PRECLUSION OF EVIDENCE NOT SPECIFIED IN A PRETRIAL MEMORANDUM.

When the Federal Rules of Civil Procedure were promulgated by this Court in 1937, they contained in Rule 16 an entirely new concept for the Federal Courts. Under this Rule, District Court judges could — in their discretion — direct counsel to appear for a pretrial conference to consider:

"(1) The simplification of the issues;
(2) The necessity or desirability of amendments to the pleadings;
(3) The possibility of obtaining admissions of fact and of documents which will avoid unnecessary proof;
(4) The limitation of the number of expert witnesses;
(5) The advisability of a preliminary reference of issues to a master for findings to be used as evidence when the trial is to be by jury;
(6) Such other matters as may aid in the disposition of the action."

The Rule further provides that "the Court shall make an order which recites the action taken at the conference . . . ;

and such order when entered controls the subsequent course of the action . . . ." Professor, and later Judge, Dobie hailed the pre-trial procedure as "a device with magnificent potentialities if properly used by able and fearless judges dealing with fair-minded lawyers." Dobie, *The Federal Rules of Civil Procedure*, 25 Va. L. Rev. 261, 269 (1939). In too many instances, however, the pre-trial process has not measured up to the expectations of Judge Dobie or the intent of Rule 16's framers. The instant case illustrates — as well as any — the pitfalls of the process when it is applied in a wooden and unyielding fashion to the substantial economic harm of a litigant. In this case, because Coleco did not state in its massive Pretrial Brief that it would prove understatements of costs by reference to 1972 invoices, it was prohibited from proving $80,000 in damages and held liable for more than $430,000. Unfortunately, the present case is not a "sport" or exception. Abuses of the pre-trial procedure are the subject of a growing number of appellate decisions — which contrast sharply with the decision below — and a stream of criticism from esteemed members of the bench and bar. Review of the present case is essential to restore Rule 16 to its proper function in federal litigation and to resolve a growing and deepening division between the circuits.

At the outset, it should be noted that the precluded evidence was not contrary to any limitation embodied in a pretrial order entered by the Court following the pre-trial conference because no such order was entered here. Rule 16 makes clear — contrary to the decision below — that it is the order of the Court and not the memoranda of the parties that controls and limits the issues at trial: "such order *when entered* controls the subsequent course of the action . . . ." (Emphasis supplied). It is axiomatic that "[i]f pre-trial is to be used for such a purpose [—*i.e.*, to limit issues for trial —] there must be a pre-trial order." *Jones v. Union Automobile Indemnity Assn.*, 287 F.2d 27, 29 (C.A. 10, 1961).

Nearly twenty years ago, Judge Clark, Reporter and a Charter member of the Advisory Committee on the Rules, expressed alarm that preclusion orders were "depriving litigants of fundamental rights" *Seminar on Procedures for Effective Judicial Administration*, 29 F.R.D. 191 (1961):

> "My concern arises because I fear the pressure of congested calendars and overburdened courts has worked toward the resort to ever severer pre-trial orders based at bottom on the failure of a litigant or, perhaps more, his lawyer to reveal all, even down to the legal theories of his case." *Id.* at 456.

Commenting on the Local Rules for the Southern District of New York, which required detailed submissions by the parties similar to the pre-trial order entered here, Judge Clark argued that "they appear . . . to bring back the outlawed special pleading with, indeed, a bang." "[The] multitude of details as to which counsel for both sides must set forth in writing in advance of the pre-trial hearing [under threat of sanctions of preclusion, default or dismissal] . . . would seem to require detailed pleading contrary to [Rule] 8(a) . . . . And this requirement of a kind of pre-pre-trial special pleading seems at war with the basic concept of F.R. 16 looking to a *conference* of Court and trial counsel, settling points of *agreement* between them." *Id.* at 458-459. (Emphasis in original.)[6]

More recently, Chief Justice Burger identified pre-trial procedures as one of the nine areas of concern requiring fundamental changes:

[6]Fourteen years later, District Judge Milton Pollack echoed similar criticisms of the Local Rules of the Southern District of New York:

> "(1) they represent a mere compilation of legalistic contentions and pleadings without any real analysis of the particular case, (2) they result in formal agreements on minutiae which have no significant effect on the result of the case, (3) they represent a burdensome chore in cases plainly destined to be settled before trial, and (4) they are ceremonial, ritualistic exercises with little actual impact or actual value to the Bar or the trier of fact."

> "Now . . . after more than 35 years' experience with pretrial procedures, we hear widespread complaints that they are being misused and overused. . . . *The complaint is that misuse of pretrial procedures means that "the case must be tried twice.'* The responsibility for correcting this lies with lawyers and judges for the cure is in our hands." Address to the National Conference on the Causes of Popular Dissatisfaction with the Administration of Justice. 70 F.R.D. 79, 95-96 (1976). (Emphasis supplied.)

Elaborating on the concern of trying a case twice, expressed by the Chief Justice, the Fourth Circuit has held that "Rule 16 was never meant to make lawyers try a case on paper . . . ." before trying it in a federal courtroom. *McCargo v. Hedrick*, 545 F.2d 393, 401 (C.A. 4, 1976). See also, Address of Judge J. Skelly Wright to the Judicial Conference of the Tenth Circuit, reproduced in part at 50 F.R.D. 454-56 (1970).

Given the abuses which have elicited expressions of alarm from such sources, there can be little doubt that the present case presents an issue urgently requiring this Court's attention. This Court has recognized its unique responsibility to oversee the construction and application of the Federal Rules. Thus, in *Schlagenhauf v. Holder*, 379 U.S. 104 (1964), it was noted that "[n]ormally, wise judicial administration would counsel remand of the cause to the Court of Appeals . . . ."

> "However, in this instance the issue concerns the construction and application of the Federal Rules of Civil procedure. It is thus appropriate for us to determine on the merits the issues presented and

to formulate the necessary guidelines in this area. See *Van Dusen v. Barrack*, 376 U.S. 612, 84 S.Ct. 805, 11 L.Ed.2d 945. As this Court stated in *Los Angeles Brush Mfg. Corp. v. James*, 272 U.S. 701, 706, 47 S.Ct. 286, 288, 71 L.Ed. 481:

'[W]e think it clear that where the subject concerns the enforcement of the * * * rules which by law it is the duty of this court to formulate and put in force * * * it may * * * deal directly with the District Court * * *.'

See *McCullough v. Cosgrave*, 309 U.S. 634, 60 S.Ct. 703, 84 L.Ed. 992, 379 U.S. at 112." 379 U.S. at 111-112.

See also *Societe Internationale v. Rogers*, 357 U.S. 197, 203 (1958). Moreover, the admittedly "drastic" consequences which befell Coleco as a result of an alleged single misstep by counsel is directly at odds with the entire spirit of the Rules.

> "It is too late in the day and entirely contrary to the spirit of the Federal Rules of Civil Procedure for decisions on the merits to be avoided on the basis of such mere technicalities. '*The Federal Rules reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome* and accept the principle that the purpose of pleading is to facilitate a proper decision on the merits.' *Conley v. Gibson*, 355 U.S. 41, 48, 78 S.Ct. 99, 103, 2 L.Ed. 2d 80. The Rules themselves provide that they are to be construed 'to secure the just, speedy, and inexpensive determination of every action.' Rule 1." *Foman v. Davis*, 371 U.S. 178, 181-82 (1962) (Emphasis supplied).

Finally, the decision below collides not only with other decisions of the Third Circuit noted above, *supra* n. 5, but also with a growing number of decisions from other circuits which have reversed preclusion or dismissal orders on the grounds that the underlying pre-trial process was wholly inconsistent with Rule 16. In *Peter Eckrich & Sons, Inc. v. Selected Meat Co.*, 512 F.2d 1158 (C.A. 7, 1975), the lower court had excluded the testimony of Plaintiff's expert witnesses because the witnesses had not been listed in the pretrial order. The Seventh Circuit reversed, holding:

> "Rule 16 was never intended to be a trap for unwary counsel and their litigants. The rule itself indicates that these conferences are held in order to produce agreement among the parties and the trial judge. . . . The order which follows such conferences is intended to be tailored to the particular case and to reflect 'agreements made by the parties.'" 512 F.2d at 1163-1164.

There, as here, "the pretrial order was little more than boiler plate. . . ." *Ibid.* Finally, the Seventh Circuit held that preclusion of Plaintiff's expert proof was "unreasonable and unfair":

> "It is often said that a trial is not a game of tactics, but a proceedings designed to achieve substantial justice among the parties. Here the trial was a game, and thus resulted in a denial of substantial justice because it was essential to its case to have expert testimony." *Id.* at 1164

More recently, the Fourth Circuit struck down a Local Rule which required submission of pretrial memoranda virtually identical to those required by the order entered by Judge Huyett.[7] *McCargo v. Hedrick*, 545 F.2d 393 (C.A. 4, 1976).

[7]The Local Rules, as amended (146a-154a), exacerbate the inconsistency between pre-trial in the Eastern District of Pennsylvania and Rule 16. See n.1, *supra*.

In ruling that Local Rule 2.08 of the United States District Court for the United States District Court for the Northern District of West Virginia was inconsistent with Rule 16, F.R.C.P., the late Judge Craven noted that good pretrial practice "is always simple" — its purpose is to strip each case to its essentials. Then, speaking on behalf of the Fourth Circuit, he found:

> "Local Rule 2.08 is a distortion of such purposes. Simplicity has been forgotten. The theory seems to be that if two pages are good, four must be better, and ten or 13 or 21 may prevent a trial altogether, as happened here. *Rule 16 was never meant to make lawyers try a case on paper instead of in a courtroom. In fact, it contemplates that the district judge himself will dictate the pretrial order.* Of course, the court may seek the aid of counsel in preparing the order, but Rule 16 should not be implemented in such a manner that the pretrial procedure itself is more difficult and time consuming than the actual trial.
>
> * * *
>
> Local Rule 2.08 subordinates the role of the lawyer to that of the administering magistrate, reducing counsel to the role of clerical assistants who are to anticipate imaginatively what other matters ought to be embraced within an endless pretrial order.
>
> * * *
>
> *The Federal Rules of Civil Procedure freed us from common law pleading. Under the guise of 'implementing' Rule 16, Local Rule 2.08 puts back into a pretrial order that which was so painfully removed from the complaint and the answer less than 40 years ago."* 545 F.2d at 401 (Emphasis supplied).

The foregoing quotations place the Fourth and Seventh Circuits in irreconcilable conflict with the decision below as to the intent of Rule 16 as well as its application. See also *Padovani v. Bruchhausen*, 293 F.2d 546, 548-549 (C.A. 2, 1961). Review by this Court is essential to resolve this conflict, to correct the abuses of the pretrial process embodied in many Local Rules and "standing orders" of the individual district judges and to restore pre-trial to the purposes envisioned by this Court and the framers of Rule 16 when it was initially adopted.

CONCLUSION

For the reasons stated herein, the Petition for Certiorari should be granted, the judgment of the Court of Appeals reversed and the cause remanded for further proceedings.

Respectfully submitted,

JOSEPH A. YABLONSKI
DANIEL B. EDELMAN

Yablonski, Both & Edelman
1150 Connecticut Avenue, NW
Suite 500
Washington, DC 20036

Attorneys for Coleco Industries, Inc.

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 76-2328, 76-2329, 76-2330, 76-2331

COLECO INDUSTRIES, INC.,
Appellant in No. 76-2328

v.

ABE BERMAN; JOSEPH RUBIN; IRVING COHEN; LEWIS M. COHEN; FREDERIC COHEN; and ZELNICK, SOBELMAN & COMPANY

Joseph Rubin, Irvin Cohen, Lewis M. Cohen, etc., appellants in No. 76-2329

Zelnick, Sobelman & Company, appellant in No. 76-2330

Abe Berman, appellant in No. 76-2331

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA
C.A. No. 73-2790

Argued October 18, 1977

Before: ADAMS and GARTH, *Circuit Judges*, and LAYTON, *District Judge.

---

*United States District Judge for the District of Delaware, sitting by designation.

JOSEPH A. YABLONSKI
CHARLES R. BOTH
DANIEL B. EDELMAN
Yablonski, Both & Edelman
Washington, D.C. 20036

DAVID BERGER
RICHARD A. SPRAGUE
MICHAEL K. SIMON
David Berger, P.A.
Philadelphia, Pa.

Attorneys for Appellant,
Coleco Industries, Inc.

DANIEL B. PIERSON, V.
Pierson, Jones & Nelson, P.C.
Philadelphia, Pa. 19107

Attorney for Appellant,
Joseph Rubin

THEODORE R. MANN
BARRY E. UNGAR
LARRY H. SPECTOR
Mann and Ungar, Prof. Assoc.
Philadelphia, Pa. 19103

Attorneys for Appellants
Irvin Cohen, Lewis M. Cohen
and Frederick Cohen

GLENN C. EQUI
BRUCE D. LOMBARDO
ROBERT J. MCKEE, JR.
Harvey, Pennington, Herting & Renneisen, Ltd.

OF COUNSEL:

HARVEY, PENNINGTON, HERTING & RENNEISEN, LTD.,
Philadelphia, Pa. 19103

MARTIN J. RESNICK
E. HARRIS BAUM
Zarwin, Baum, Arangio & Somerson, P.C.
Philadelphia, Pa. 19107

Attorneys for Appellant,
Abe Berman

OPINION OF THE COURT

(Filed November 25, 1977)

PER CURIAM:

This factually-complex case arises out of the 1973 acquisition of Royal All-Aluminum Swimming Pool Corp. by a 100% stock purchase on the part of Coleco Industries, Inc. Royal's shareholders were Abe Berman, Joseph Rubin, and Irvin, Lewis and Frederick Cohen. Berman acted as president and sales manager, Rubin functioned as vice president, design engineer and production manager, while the Cohens provided financial support to Royal. Berman, Rubin and the Cohens, along with Zelnick, Sobelman and Co., Royal's accountants, were the defendants in the $1.3 million securities fraud action which forms the nucleus of the complaint in this case.

The trial court's extensive opinion, reported at 423 F. Supp. 275-324 (E.D. Pa. 1976), sets forth the circumstances of this case in detail. We therefore present only a capsule review of the events giving rise to the lawsuit.

I. THE FACTS

A. History of the Case

In 1971, Berman, Rubin and the Cohens incorporated Royal, with the objective of using Berman and Rubin's expertise in manufacturing and marketing above-ground aluminum swimming pools. Royal had a moderately successful year in 1972, making inroads on other pool suppliers' markets, but sold 600 instead of an expected 900 pools, sustaining a net loss of $172,000.[1]

The combination of a potentially-successful product and a financial squeeze caused by under-capitalization attracted the attention of Coleco, a Connecticut corporation active in the swimming pool field. After initial inquiries in January of 1973, negotiations commenced regarding the

1. The initial capitalization of the firm was $84,000 and a bank loan provided an additional $100,000.

purchase of Royal by Coleco. While the original proposition discussed was a $1 million acquisition, the Coleco principals wished to defer consummating the arrangement in order to await the performance of a certified audit of Royal. The Royal officials pressed for an immediate purchase, contending that Royal's current financial situation was so fragile that an immediate infusion of new capital was necessary.

The difference was resolved by a purchase agreement which provided for a firm $500,000 to be paid in four installments, and $500,000 of the purchase price to be made contingent upon the profitability of Royal in succeeding years. In addition, the Royal principals warranted the correctness of Royal's financial statement for the first quarter of 1973 (April 30 statement). Rubin and Berman were to be retained to manage the company at specified salaries. The agreement of sale was signed on June 4, 1973. It is conceded that the April 30th statement underestimated the total inventory set forth by Royal by at least $49,922.

By November 1973, Rubin had quit, Berman had been fired, Coleco had expended—by its estimates—$1.3 million on Royal, Royal had barely broken even, and Coleco was in the process of transferring what was left of Royal to its subsidiary ABCO.

Coleco filed suit on December 4, 1973. The proceeding began as a jury trial, but halfway through the jury was dismissed. After the evidence was closed, Judge Huyett made extensive findings of fact and conclusions of law which are set forth in the course of his opinion.

The interpretation of how matters advanced through each of the various stages is, of course, hotly contested. The first dispute centers on the representations which were made to Coleco before the sale. Coleco claims it was misled as to the profitability of Royal. It points out that on April 18, 1973 Rubin told a Coleco principal that Royal was realizing a gross profit of $500 per pool, and that the April 30, 1973 first quarter report showed a gross profit of $200,000 on the sale of 400 pools.

All parties agree that the April 30 statement was in error, underestimating the cost of the pools manufactured by $49,922, as a result of accounting errors. In addition, Coleco claims that by comparing the April 30 figures with the figures derived from a June, 1973 audit, the cost of the 400 pools was understated by an additional $80,272.[2]

Berman, Rubin and the Cohens (hereinafter the "Royal defendants") respond that the April 18 representation regarding the gross profit per pool was made in good faith. The trial court agreed, finding that the representation was that Rubin "believed" that he was making $500 per pool, and that such was in fact the state of Rubin's belief (423 F. Supp. 285, 289). Moreover, the Royal defendants challenge the plaintiff's accounting methods, admitting only the $49,992 discrepancy, and argue that they were misled as much as the plaintiff by the errors of Zelnick, their accountant. The trial court did not pass on this contention explicitly, although it found Zelnick liable to the defendants for the $49,922 error, on the basis of Zelnick's "obvious and mechanical" mistakes (423 F.Supp. 308-310, 310 n.59).

The major factual disagreement between the parties regarding the various events following the purchase concerns the cause of the business difficulties experienced by Royal. All admit that by the end of the summer, Royal was unable to meet the orders for which it had contracted, and that its operation was beginning to fall apart despite overtime work on the part of Rubin.

Coleco claims that the operation was doomed from the start, given the underestimated profit margin. The Royal defendants contend that the root of the problems was mismanagement by Coleco. While the trial court found that

---

2. Coleco also claimed at trial that one of the new lines of pools manufactured in 1973 by Royal was defectively designed, and that this item was covered by the warranties accompanying sale.

The Royal defendants contended that the subsequent failures in the pools were the result of shoddy workmanship by suppliers, and that Coleco had been informed of difficulties experienced in obtaining appropriate work from suppliers before the Coleco purchase. This dispute receded to the background on appeal, perhaps because the trial court found that even assuming that the pool failures were actionable, no damages had been proven as a result of such failures.

Rubin had informed Coleco that successful operation on the scale it contemplated would require immediate infusions of capital, along with personnel and materiel from Coleco, in fact the expenditures of money by Coleco on the Royal operation were delayed, and the men and materials never arrived. Moreover, Coleco's management antagonized both Rubin and Berman, the lynchpins of the operation, to the point where one left and the other had to be discharged.

The trial court supported the Royal defendants, finding that "Royal failed, we find it much more probable than not, because Coleco mismanaged it after the acquisition."[3]

Berman and Rubin both assert that they were driven out—Berman that he was fired without cause, and Rubin that he was forced to resign by intolerable working conditions and lack of cooperation. Both seek to recover the salaries promised them under the contract. Coleco responds that Berman had been derelict in his duty, and that under New Jersey law Rubin's resignation bars recovery on an employment contract. The trial court found for Rubin and against Berman.

B. The Suit

By the time this case reached trial, each of the parties, except Zelnick, had invoked a plethora of remedies. Zelnick, however, had settled with Coleco for $350,000 and had became a third-party defendant. In broad overview, the holdings of the trial court were as follows:

(1) Coleco had no valid claim under 15 U.S.C. § 78j(b) and SEC Rule 10b-5. Whatever misrepresentations occurred were made in the belief of their truth or were not "studied." Thus the *scienter* necessary for a securities violation was lacking.

(2) Coleco had no valid common-law fraud claim. The *scienter* necessary for a 10b-5 violation is identical to that essential for fraud. Since the former was absent, the latter was also lacking.

3. 423 F. Supp. at 293.

(3) Coleco was entitled to recover for breach of warranty, but:

(a) no damages were proved for the design defect contention (the court assumed without deciding that the warranty had been breached);

(b) the disputed $80,272 discrepancy was not properly proved;

(c) damages for breach of the warranty of correctness of the April 30 statement were limited to the actual discrepancy between the correct figures and the ones warranted, and recovery on this item was thus limited to $49,992.

(4) Whatever recovery Coleco was entitled to on the breach of warranty was satisfied by the settlement with Zelnick, under the New Jersey "one settlement" rule.

(5) The Royal defendants were entitled to recover the unpaid portion of the $500,000 non-contingent sales price and for the loans they had made to Royal, because the financial discrepancy was not a material breach and because to interpret the purchase agreement as barring recovery would be to read it as a penalty which would be unenforceable. The total amount awarded on this claim was $480,000.

(6) The Royal defendants were not entitled to recover their share of future profits, since such profits could not be proved with sufficient certainty.

(7) Rubin was entitled to his total remaining $70,506 salary, because he left after his position had been made intolerable by Coleco.

(8) Berman was not entitled to his salary, since his discharge was with cause.

(9) Zelnick was liable to the Royal defendants for the damages awarded on the basis of the breach of financial warranty (in fact, nothing).

(10) Coleco was entitled to only $15,000 of the claimed $410,550 counsel fees.

With the exception of the design-defect finding and the award of counsel fees,[4] all the parties appealed from the determinations adverse to their contentions. The Royal defendants then moved to dismiss Zelnick's appeal as moot, since under the district court's order, Zelnick has no remaining liability.

We affirm the trial court's decision on issues 1, 2, 3, 4, 5, 6, and 8; remand for recomputation of damages on issue 7; and dismiss the appeal as moot on issue 9.

II. The Issues

In view of Judge Huyett's extensive opinion, we shall canvass in summary fashion the areas of agreement with his holdings.

A. Securities Fraud

In evaluating the plaintiffs' contentions that the Royal defendants had violated 10b-5, Judge Huyett held that "to establish the element of scienter in an action brought under section 10(b) and Rule 10b-5, a party must prove injury resulting from a conscious deception or from a misrepresentation so recklessly made that the culpability attaching to such reckless conduct closely approaches that which attaches to conscious deception." (423 F. Supp. at 796).

The Supreme Court has recently announced, in *Ernst & Ernst v. Hochfelder*, that "*scienter*" is a necessary element of a violation of Rule 10-b(5).[5] We agree with the trial judge, and the majority of the courts which have passed on the question since *Hochfelder*, that plaintiff may recover under Rule 10b-5 for misrepresentations that are recklessly made as well as those made with conscious

4. Coleco's brief suggests that if damages are recomputed, then attorney's fees should also be re-examined. Since the court does not disturb the final damage award, we need not discuss the contention regarding counsel fees.

5. 425 U.S. 185 (1976).

fraudulent intent.[6] We need not precisely define the nature of the recklessness which might give rise to 10(b)(5) liability, however, for the finding by the trial court that the actions of the Royal defendants were not reckless is amply supported by the record under any of the standards which other courts have suggested.

The trial court specifically determined that the Royal defendants represented to Coleco the condition of Royal as they believed it to be, and that they were "forthright in their dealings with . . . Coleco and did not deliberately misrepresent any aspect of Royal's status or operation."[7] Judge Huyett found as a fact that Rubin "expected Zelnick, Sobelman & Co. to be totally responsible for Royal's accounting, including the costing of the various pool models."[8] He held that the proven errors in the April 30 financial statement could be traced to Zelnick's failure properly to examine the statement, and that the Royal defendants were entitled to recover damages suffered as a result of their reliance on Zelnick in this regard.[9]

Coleco has adduced no evidence which indicates that the reliance on Zelnick's expertise by the Royal defendants was outside the bounds of commercial prudence. Indeed, the only information suggested which might have alerted Royal to inaccuracies was equally available to Coleco.[10]

6. This issue was specifically left open by *Ernst & Ernst v. Hochfelder*, 475 U.S. at 194 n.12. Cases which have allowed recovery for "reckless" conduct include: *Sunstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033 (7th Cir. 1977); *Sanders v. John Nuveen Co., Inc.*, 554 F.2d 790 (7th Cir. 1977); *Wright v. Heizer Corp.*, (slip op. No. 76-1140, June 30, 1977, 7th Cir.); *Bailey v. Meister Brau, Inc.*, 535 F.2d 982 (7th Cir. 1977); *Herzfeld v. Laventhol, Krekstein, Horwath and Horwath*, 540 F.2d 27 (2d Cir. 1976); *cf. Arthur Lipper Corp. v. SEC*, 547 F.2d 171 (2d Cir. 1976) (Friendly, J.) (subjective intent or knowledge not necessary to sustain SEC disciplinary proceeding).

7. 423 F. Supp. at 285, 289.

8. *Id.* at 281.

9. *Id.* at 308-310.

10. In May, 1973, immediately before the sale, an "examining team" from Coleco checked Royal's books, and found that costs had been underestimated by $70 per pool. 423 F. Supp. at 286-87. This circumstance differentiates this case from a "face-to-face" transaction with an unsophisticated private investor. The *scienter* required for a 10b-5 violation in dealing with an experienced buyer who is expected to examine the seller's business thoroughly may well be a more culpable state of mind than that necessary to a violation in public offerings.

Under these circumstances, we do not believe the trial court erred in finding no "reckless" behavior on the part of the Royal defendants.

B. Common-Law Fraud and Breach of Warranty

As alternative claims, the plaintiff maintained that it should be able to recover for defendants' misrepresentations on two state law theories: (1) that the representations of profitability and competent design, particularly those contained in the contract, constituted common-law fraud under New Jersey law; and (2) that the failure of the April 30th financial statement and of the pool design to be in accord with the contractual representations of accuracy and soundness, respectively, were breaches of warranty.

The trial court held that no actionable fraud had accurred inasmuch as the standard of *scienter* for common law fraud was identical with that necessary for 10b-5. On the warranty claim, the court found that the admitted $49,992 underestimation of inventory cost in the April 30 statement breached the financial warranty, and it awarded $49,992 as damages. However, it rejected plaintiffs' claim for a recovery of all monies expended in buying and refinancing Royal. Judge Huyett also concluded that, assuming the design defects, if any, breached warranties, no damages had been proven as a result of such breaches.

Plaintiff challenges the failure to find liability on the fraud count as well as the court's calculation of damages on the warranty claim.

(1) *Liability*

As a matter of general common law, Judge Huyett's findings of good faith and lack of recklessness negative the assertion of fraud on the part of the Royal defendants. And while common law standards in New Jersey may be read to extend the rubric of fraud beyond the bounds of commercial recklessness,[11] Judge Huyett's failure to recognize such a cause of action is not ultimately at issue here.

There is no question but that the allegedly fraudulent assertions in the April 30 statement also constituted a breach of warranty. As we understand the law of New Jersey, on this record, the damages recoverable for fraud are identical to those recoverable for breach of warranty.[12] A potential finding of fraud is, therefore, superfluous, and the only issue before us regarding the misrepresentations is the correctness of the damage calculations.

(2) *Damages*

(a) *Proof*

It is necessary to review an evidentiary ruling made by Judge Huyett regarding evidence proffered by the plaintiff on the issue of proof of damages.

In its pretrial memorandum, Coleco indicated that it intended to prove under-costing by comparing the cost sheets prepared for the June, 1973 inventory with cost figures contained in the financial statement for the quarter ending in April, 1973, the financial statement that the de-

11. The discussion of the parties focuses on the doctrine of *Plimpton v. Friedberg*, 110 N.J. 427, 166 A.2d 295 (1933) (mirsepresentation put forward as made on basis of personal knowledge is fraudulent, when in fact based on opinion of others). In our judgment, *Zeliff v. Sabbatino*, 15 N.J. 70, 104 A.2d 54 (1954) and *Palmiere v. Forte*, 56 N.J. 155, 265 A.2d 539 (1970), are more apposite.

In *Zeliff* the court upheld a finding of fraud grounded on the defendant realty sellers' misrepresentation, in the contract of sale, regarding the cost of oil used to heat a property. The trial court held, and the Supreme Court affirmed the holding, that "the representation was false, and since defendants stated it as a matter within their own knowledge, it was actionable."

In *Palmiere* the court reversed a finding for the defendants based on a misrepresentation in a stock purchase agreement that a company had an outstanding order for 13,000 units of its produce. Although the sellers' representation was in turn based on a misrepresentation made to them by a company official, and the court described them as innocent, they were held to be liable to the buyers. Apparently, the liability was predicated upon a theory of breach of warranty, rather than fraud, but the court seemed to make no clear distinction, citing *Zeliff* as controlling.

12. *Zeliff*, *supra*, the leading New Jersey case on damages for fraud announced the following rule: While generally, the plaintiff in a fraud case is entitled to recover "the proximate result of his wrong-doing, if the fraudulent representation also amounts to a warranty, recovery may be had for loss of the bargain, because fraud accompanied by a broken promise should cost the wrongdoer as much as the latter alone." 15 N.J. at 75, 104 A.2d at 56.

fendants had warranted as accurate. The differential came to $80,272.00 more than the $49,992 by which the defendants admitted erring. At the hearing on the plaintiff's summary judgment motion, which occurred before trial, defendants challenged the June, 1973 figures, on the ground that such figures could not be taken to represent the true costs as of the time of the April 30 statement. Defendants maintained that under Royal's first-in-first-out accounting, the proper invoices to examine for costing would have been those for materials bought in 1972, and used in the first quarter of 1973. Since the price of aluminum, the material used to construct the pools, was rising rapidly during 1972-73, defendants argued, costing based on 1973 invoices could be used as neither proof of inaccuracy nor proof of damages.

Without amending their pretrial statement, or notifying defendants' counsel, Coleco thereupon commissioned a Philadelphia accounting firm to study 1972 supply invoices with regard to their similarity to 1973 prices. When Coleco attempted to introduce the findings of the new study by an expert witness, the defendants objected. The trial judge ruled that in light of the failure of plaintiff's pretrial filings to disclose the study or its prospective use, to admit it would subject defendants to unfair surprise and prejudice.

In view of the fact that plaintiff had been specifically ordered to notify counsel and the court of the substance of testimony by witnesses,[13] and that no excuse was presented by Coleco's counsel for its failure to advise the court earlier

13. Plaintiff argues that since no pretrial order was issued explicitly binding them to reliance on 1973 invoices "in accordance with Local Rule 7(f)," it was error to exclude the evidence. One difficulty with this argument is that Local Rule of Procedure 7(f) of the Eastern District of Pennsylvania became effective in July 1976, while the case was tried during the winter and spring of 1975-76. The prior Rule 7 made no explicit provision for a pretrial order, and indeed contemplated the required pretrial memorandum as having preclusive effect, at least as to witnesses.

Most importantly, in August of 1975, the district court issued a pretrial order requiring the plaintiff to file a pretrial memorandum including "plaintiffs' contentions as to disputed facts," and "Plaintiffs' final designation of witnesses to be called at trial . . . briefly identifying each witness and specifying the evidence which the witnesses will give." Given this order, it is not an abuse of discretion to prevent the plaintiffs from introducing a study of 1972 invoices which they neglected to mention before its introduction at trial.

that the evidence would be offered, we do not believe it was an abuse of discretion to refuse to receive the plaintiff's proffered proof.[14]

We therefore must accept as correct the trial court's conclusion that costs were underestimated in the April 30th statement by only $49,992.

(b) *Calculation*

At trial and before this Court, plaintiff's counsel focused on the contention that the underestimation of costs struck at the heart of the bargain which Coleco had been led to expect; instead of buying a potential gross profit of 36%, plaintiff argues, under the facts as Judge Huyett found them gross profits were closer to 20%. Increased costs and lowered profits, Coleco asserts, meant that Royal was commercially worthless. Therefore, according to Coleco, it is entitled to the full $1.3 million in out-of-pocket expenditures which represents the costs of obtaining and operating Royal.

While we recognize that under New Jersey law damages for fraud or breach of warranty seek to compensate a

14. The sanction chosen by Judge Huyett was a drastic one, and two recent decisions of this Court have applied relatively strict scrutiny for abuse of discretion in the case of evidentiary exclusions. *Dudley v. S. Jersey Metal, Inc.*, 555 F.2d 96 (3d Cir. 1977) and *Myers v. Pennypack Woods Home Ownership Assn.*, (3d Cir. No. 76-2223, slip op. July 1977). The crucial factors in the *Dudley* holding, that failure to grant a mistrial with costs taxed to the defendant, was an abuse of discretion were (1) a lack of willfulness on the part of the defendant whose evidence was excluded, and (2) a contributory neglect by the plaintiff.

In *Myers*, the trial court's refusal to admit testimony of a witness not named in a pretrial memoranda was struck down as an abuse of discretion, on the basis of four factors: "(1) the prejudice or surprise in fact of the party against whom the excluded witnesses would have testified; (2) the ability of that party to cure the prejudice; (3) the extent to which waiver of the rule against calling unlisted witnesses would disrupt the orderly and efficient trial of the case or of other cases in the court; and (4) bad faith or willfulness in failing to comply with the court's order." (slip op. at 17). Here, as in *Myers*, there was no explicit finding of willfulness or bad faith. Nonetheless, unlike *Myers*, no explanation was proffered for the failure to inform defense counsel of the existence of the studies prior to trial. And, in contrast to *Myers*, the evidence was revealed in the midst of trial rather than three weeks before trial. Finally, proper rebuttal of or impeachment of the accounting study might well have required extensive investigation and preparation. Adjournment of several weeks in the midst of a complex trial which ultimately lasted months is a significant disruption of the trial process.

plaintiff for his "loss of the bargain"—the difference between the worth of the article as represented and that as actually delivered [15]—the record does not contain evidence which satisfactorily establishes the worth of Royal either as represented or as delivered. We agree with Judge Huyett's conclusion that the allegation that Royal was worthless is insufficiently supported by the record.[16] Nor can we say that it was error to hold that the plaintiff failed to prove by a preponderance of evidence the degree to which Royal's worth as delivered was less than as represented. Indeed, we find little testimony in the record which bears on such a calculation. The only loss of the bargain actually proven was that which the trial court in fact awarded: the $49,992 by which the April 30 statement overestimated the inventory.

Likewise, we do not believe the trial court erred in rejecting Coleco's demand for reimbursement for the out-of-pocket expenditures made on behalf of Royal. Judge Huyett held that Coleco had not proven by a preponderance of the evidence that the misrepresentation of the April 30 statement resulted in the $1.3 million out-of-pocket expenditures. We cannot say that this conclusion was reversible error, particularly in light of the fact that over $600,000 of the amount claimed was expended after Royal learned of the inaccuracies in the April 30 statement.[17]

(c) *The "One Satisfaction" Rule*

Judge Huyett held that any recoveries due from the Royal defendants to Coleco should be offset by Coleco's

15. *Zeliff v. Sabbatino*, 15 N.J. 70, 75, 104 A.2d 54, 56 (1954). *See* note 12 *supra*.

16. Judge Huyett chose not to credit the testimony of Edward Fialkowski, Coleco's treasurer, that had Royal's balance sheet showed a deficit, Royal would have had no value. 423 F. Supp. 366 at 52.

We cannot say that Judge Huyett erred in finding that this testimony is unpersuasive. Indeed, the testimony of Coleco's president, Arnold Greenburg, is that even had the costs been underestimated by $100,000 (rather than the $49,992 actually proved), he would still have purchased Royal, albeit at a lower price. (Transcript 250-251).

17. *See* Plaintiff's brief pp. 15-25.

$350,000 recovery from Zelnick.[18] That conclusion is not erroneous. The fact that the compensation from Zelnick was obtained on a different theory from that which Coleco asserts against Royal is not controlling under New Jersey law, so long as the damages recovered are the same. Likewise, we believe that the trial court's conclusion that the policy of the New Jersey courts of applying the "one satisfaction" rule only to obtain a "just result," and not on behalf of wrongdoers,[19] presents no bar to its use in the present action.

C. Purchase Price and Loan Repayment Counterclaims, Future Profits

The Royal defendants counterclaimed against Coleco for the balance of the $500,000 non-contingent purchase price which they had not yet received, as well as for certain sums of money which they had loaned to Royal. Plaintiff asserted as a defense to this counterclaim a clause in the purchase agreement that "obligations of Coleco under the agreement shall at all times be subject to the condition precedent . . . [that] representations and warranties . . . contained . . . shall be true on and as of the closing date." [20]

Judge Huyett construed this condition precedent to apply only to the obligations under the purchase agreement to close the contemplated arrangement, and concluded that if a $49,992 inaccuracy could excuse payment of a $500,000 purchase price after the closing had occurred and Coleco had taken possession of Royal, such a clause would be unenforceable as a penalty.

While this ruling may not necessarily be compelled by the record, Judge Huyett's decision is not without substantial evidentiary support. The other paragraphs in the

18. *Breen v. Peck*, 28 N.J. 351, 146 A.2d 665, 671 (1958); *Dailey v. Somberg*, 28 N.J. 372, 146 A.2d 676, 684 (1958).

19. *Theobald v. Angelos*, 44 N.J. 228, 208 A.2d 129 (1965).

20. Joint appendix at 231.

agreement concerning conditions precedent all refer clearly to conditions precedent to closing. In view of the refusal by the New Jersey courts to enforce contractual provisions which act as penalties, Judge Huyett's interpretation will be affirmed.[21]

Similarly, the trial court's finding that the breaches of the contract were not so material as to entitle Coleco to retain Royal without tendering the contractual payments is not reversible error. Had Coleco attempted to rescind immediately upon learning of the misrepresentations, a different situation might be presented. After Coleco absorbed Royal into its subsidiary, however, we cannot say that Judge Huyett erred in holding that Coleco is required to pay the purchase price set forth in the contract less the damages that it established.

We also uphold the trial court's determination that the Royal defendants were not entitled to that portion of the purchase price which was made contingent upon profits. Royal was a fledgling business enterprise, and its future profits were not sufficiently certain so as to be susceptible of accurate determination.

D. Salary Claims

(1) *Berman*

Mr. Berman counterclaims against Coleco for the salary which he was to receive as president of Royal under the purchase and employment agreements. Coleco maintains that the contractual breach was Berman's, and that he was discharged for cause. In view of the evidence that "Berman's office work was a disaster,"[22] and that Berman had at one point gone on vacation for several weeks without leave,[23] Judge Huyett's conclusion that Berman

21. *See Barr & Sons, Inc. v. Cherry Hill Ctr. Inc.*, 217 A.2d 631, 90 N.J. Super. 358 (1966) (rebate of all rental paid triggered by breach of restrictive covenant); *Westmount Country Club v. Kaceny*, 197 A.2d 379, 82 N.J. Super. 200 (1964); *Keller v. Architects Display Bldg. Inc.*, 148 A.2d 634, 54 N.J. Super. 205 (1959) (unconscionably high interest is penalty).

22. 423 F. Supp. at 314.

23. *Id.*

was dismissed for cause and therefore had no claim for future salary was neither factually or legally erroneous.

(2) *Rubin*

Similarly, we cannot overturn Judge Huyett's conclusions regarding Mr. Rubin. Judge Huyett found that by making arrangements to move the bulk of Royal's operations out of New Jersey, in violation of a contractual provision, as well as by making Rubin's situation as vice-president of Royal untenable, Coleco breached its contract with Rubin. He further found that Rubin's subsequent resignation was a mere acknowledgment of a contractual breach. We do not view these determinations to be erroneous. The New Jersey cases in which resignation has been held to bar an action for breach of an employment contract are factually distinguishable.

At oral argument, counsel for Rubin admitted that his recovery should be reduced by any earnings which Rubin in fact received between the close of trial and the end of the contractual period. We suggested that counsel for Mr. Rubin submit a statement of these earnings to counsel for Coleco, and that the attorneys attempt to reach an agreement on the appropriate set-off. On this issue, the case will be remanded to the district court, and should no agreement eventuate, the district court is directed to offset Mr. Rubin's recovery by the amount which he actually earned through November 1, 1976.

E. Liability of Zelnick

Since we hold that the district court did not err in its computation of damages, recovery by Coleco against the Royal defendants is offset entirely by the $350,000 settlement between Zelnick and Coleco. Since Zelnick is thus exposed to no liability as a result of the judgment against it, Zelnick's appeal becomes moot and must be dismissed.

III. Conclusion

The judgment of the trial court will be affirmed except as it bears on Rubin's wage claim. On the issue of Rubin's wages, the case will be remanded for action in accordance with this opinion.

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

(A.O.—U. S. Courts, International Printing Co., Phila., Pa.)

APPENDIX B
COLECO INDUSTRIES, INC. v. BERMAN

Cite as 423 F.Supp. 275 (1976)

Reproduced with permission from 423 F.Supp. 275, Copyright ©1977 By West Publishing Co.

COLECO INDUSTRIES, INC., Plaintiff,
v.
Abe BERMAN et al., Defendants,
v.
ZELNICK, SOBELMAN & COMPANY,
Third-Party Defendants.
Civ. A. No. 73-2790.

United States District Court,
E. D. Pennsylvania.
Aug. 9, 1976.
As Amended Dec. 1, and Dec. 21, 1976.

Litigation arose out of a contract for the purchase of a business by plaintiff from defendants. The District Court, Huyett, J., held that defendants breached a contract provision whereby they warranted certain financial statements. Under evidence, the more probable cause of immediate postacquisition difficulties of such business and its eventual disintegration was not problems arising from breaches of contract by defendants but from plaintiff's miscalculation of kind and amount of assistance needed to enhance chances of success. Plaintiff failed to establish damages under its enterprise theory of liability. Notwithstanding lack of strict privity, accountants are liable in negligence for careless financial misrepresentations relied upon by actually foreseen and limited classes of persons. There was a breach by the plaintiff of its employment contract with one defendant but another

defendant breached his employment contract with the plaintiff. Though the contract provided for recovery of attorneys' fees by the plaintiff the award would be limited to $15,000.

Judgment for plaintiff against all defendants in amount of $15,000; judgments for each of two defendants against plaintiff, on counterclaims; judgment for other defendants and against plaintiff.

OPINION AND ORDER

HUYETT, District Judge.

INTRODUCTION

This dispute arose, we have concluded after months of considering the legal and factual convolutions of this case, out of the frustration and need to assign fault engendered when an important business deal went sour. On June 4, 1973, after two and one-half months of negotiation, plaintiff Coleco Industries, Inc. (Coleco), a Connecticut manufacturer of recreational products, including toys, swimming pools, and swimming pool accessories, purchased Royal All-Aluminum Swimming Pool Corp. (Royal), a smaller New Jersey corporation specializing in the design, packaging, and distribution of above-ground aluminum pools. The purchase was effected by the transfer to Coleco of all shares of outstanding Royal capital stock by the five Royal stockholders—Abe Berman, Royal's president, and Joseph Rubin, Royal's secretary-treasurer, both of whom managed Royal's daily operations, and Irvin, Lewis, and Frederick Cohen,

brothers and outside shareholders.[1] Subsequent to the purchase date in June 1973, Royal's fortunes went quickly and steadily downhill and by 1975 Royal All-Aluminum Swimming Pool Corp. was inoperational. Plaintiff Coleco did not wait until 1975 to bring suit, however. Under the terms of the 1973 Purchase Agreement (Ex. 1), which contemplated both contingent and non-contingent payments to Berman, Rubin, and the Cohens,[2] Coleco, at closing, paid to the Royal shareholders $135,000 of the $500,000 non-contingent purchase price plus 6% interest. The second non-contingent payment of $57,500 plus interest was due in January 1974. Coleco initiated suit against all five Royal shareholders and Royal's accountants in December 1973, however, and made no payment beyond the amount paid at closing.

Under the complaint filed in December 1973, which is jurisdictionally grounded both in the federal securities laws and diversity of citizenship,[3] Coleco demands dam-

1. Of the total of 180 Royal shares outstanding prior to purchase, Berman held sixty, Rubin sixty, Irvin Cohen thirty, Lewis Cohen fifteen, and Frederick Cohen fifteen. (Purchase Agreement, Ex. 1, ¶ 1.1)

2. The non-contingent payment amounted to $500,000 plus interest payable in four installments; the contingent payment geared to Royal's profits over three years amounted to a maximum of another $500,000. (Purchase Agreement, Ex. 1, ¶¶ 1.2–1.4)

3. Plaintiff invokes jurisdiction pursuant to 15 U.S.C. § 78aa of the Securities Exchange Act of 1934 and 28 U.S.C. §§ 1331 and 1337 and brings its federal securities claim pursuant to

ages of nearly one and one-half million dollars against the five Royal shareholders, Berman, Rubin, and the Cohens,[4] for securities fraud, common law fraud, and breach of contract. The complaint also named as a defendant, Zelnick, Sobelman, & Co. (Zelnick), Royal's accountant from its inception in 1971 through the June 1973 purchase date. Just prior to trial, however, Coleco and defendant Zelnick reached a settlement which shifted Zelnick's posture in the case from that of defendant to that of third-party defendant since there remained claims against Zelnick by defendants Rubin and the Cohens. All defendants filed counterclaims demanding the remainder of the purchase price as well as repayment of their personal loans to Royal, another part of the contract consideration.[5] In addition, Berman and Rubin counterclaimed for breach of their employment contracts with Coleco executed at the same time as the Purchase

15 U.S.C. § 78j(b) and Rule 10b–5. Its claims based on common law fraud and breach of contract are brought under 28 U.S.C. § 1332.

4. During the pendency of this litigation defendant Frederick Cohen was lost and presumed dead in an airplane accident. His estate has been substituted as defendant. (Tr. at 31:3946–47)

5. Under the terms of the Purchase Agreement (Ex. 1, ¶ 12.1), plaintiff was not to begin repaying defendants' personal loans to Royal until January 2, 1974. Thus, when Coleco filed suit in December 1973 and stopped all future payment under the Purchase Agreement, it stopped repayment on defendants' loans.

Agreement and related to it.[6] Finally, the Cohen defendants crossclaimed against Berman and Rubin on the basis of a side agreement entered into at the June 1973 closing between Berman and Rubin on one hand and the Cohens on the other (Ex. 397), under the terms of which any breach damages due Coleco out of the non-contingent purchase price would come first out of Rubin's and Berman's shares.

I

FINDINGS OF FACT

Following almost two years of discovery and other pretrial activity, we tried this case non-jury[7] beginning November 10, 1975, and continuing, with a few interruptions, to January 29, 1976; the trial record exceeds 4000 pages. Now, having reviewed with care the notes of testimony, the documentary evidence submitted, and the post-trial briefs and proposed findings of fact and conclusions of law, we find the case ripe for decision.

6. As part of the total transaction by which Coleco acquired Royal, Coleco hired Berman and Rubin as president and vice-president respectively of Royal. Moreover, a large amount of the purchase price contingent on Royal's profitability was also contingent on Berman's and Rubin's fulfilling their employment contracts. (Purchase Agreement Ex. 1, ¶ 1.4(d)(ii))

7. We began trial with a jury. On the joint motion of all parties, we agreed in the interest of fairness and judicial economy to dismiss the jury and proceed non-jury. (Tr. at 18:2074–78c)

For ease of understanding, we choose to document our findings of fact and conclusions of law in narrative form rather than in separately numbered paragraphs.[8] The narration that follows shortly, then, constitutes our findings of fact required under Fed.R.Civ.P. 52(a). In making our findings, we reply perhaps most heavily upon the lengthy testimony of Joseph Rubin, one of the defendants. His demeanor and the substance of his testimony impressed us greatly; he was a straightforward, conscientious, and intelligent witness. In crucial areas where his testimony contradicts that of plaintiff's witnesses, we credit Mr. Rubin's testimony. We also credit substantially the testimony of Abe Berman, especially that testimony dealing with information about Royal that he revealed to Coleco's officers, agents, and representatives prior to June 4, 1973.

A. *1971 Through March 1973*

Joseph Rubin, a mechanical engineer with a B.S. in engineering, met Abe Berman in 1968 while they were both working for Esther Williams Swimming Pool Co. Berman is a high school graduate who has worked in sales all his adult life. At Esther Williams, Rubin was responsible for the design of a new line of pools, and Berman was the company's national sales manager. Sometime in 1971, Berman and Rubin, now

8. Where the facts are substantially undisputed, we will not refer to the notes of testimony; where they are disputed, we will cite to the notes of testimony.

vice-president of Gindy Manufacturing Co., discussed seriously the prospect of their going into the swimming pool business together. As Berman explained the situation:

> I don't know who brought it up or what, but the fact remained that he [Rubin] in his experience and knowledge of production and design and my experience in promotion and sales, we just felt that it would be a real good combination for starting our own company, if we could acquire capital. . . .

Tr. at 28:3609. To acquire capital, Rubin contacted Irvin Cohen, a Reading, Pa., businessman, with whom he had had business dealings and interested Cohen and through Cohen his two brothers, Lewis and Frederick, in investing in the proposed company. In addition to investing his own money, Irvin Cohen could aid Rubin and Berman in their enterprise through his contacts with Reading banks which made likely the prospect of the new company's obtaining a loan. As a result of this activity, then, Royal All-Aluminum Swimming Pool Corp. was formed in late Summer or early Fall 1971 with an initial capitalization of $84,000—$12,000 each from Rubin and Berman and $60,000 from the Cohens together. Because Irvin Cohen wanted Royal to use as its accountant the accounting firm that he employed for his other enterprises, Royal hired the firm, Zelnick, Sobelman, & Co., in the Fall of 1971 for a retainer of $300 a month. Rubin told Norman Zelnick that because he had no significant accounting knowledge (Tr. at 20:2412–13) and because both he and

Berman would be constantly occupied with design, production, and sales (Tr. at 20:2412), he expected Zelnick, Sobelman, & Co. to be totally responsible for Royal's accounting including the costing of the various pool models which Royal would market. Zelnick agreed to this undertaking. Tr. at 20:2417 & 2418. Rubin designed three pools in Fall 1971, the Crest pool, which came in two sizes, the Crown pool, in two sizes, and the Jewel pool, which came in four sizes. Royal went into production in December 1971 and shipped its first pools in March 1972, Rubin and Berman projecting a sales total of 900 pools for the 1972 season.

In January 1972 Royal obtained a $100,000 loan from the National Central Bank in Reading. Also, in January 1972, Rubin and Berman met Leonard Greenberg, Coleco's then president,[9] at a National Swimming Pool Association trade show. Greenberg was apparently impressed with Royal's products and suggested to Berman the possibility of Coleco's acquiring Royal. Tr. at 28:3619. Berman responded that since Royal had not yet done a year's business, he thought the suggestion premature. Tr. at 28:3619. Leonard Greenberg followed up this conversation with a letter dated February 4, 1972 (Ex. 7), in which he reiterated his interest in discussing Coleco's acquisition of Royal.

Royal was to sell only 600 of the 900 pools projected in 1972, at least in part because

9. Leonard Greenberg is now Coleco's Chairman of the Board of Directors; his brother, Arnold Greenberg, is Coleco's present president.

June 1972, one of the key months for pool sales, was an inordinately rainy month and pool sales suffered accordingly. By Fall 1972, because of this discrepancy between the number of pools sold and the number projected, Royal had a substantial amount of inventory on hand for which it couldn't pay its suppliers. Its financial condition was poor, and in late 1972 and early 1973 its five shareholders made it various personal loans; some of which were repaid. The balance of the loans, $43,333.44, remained outstanding on June 4, 1973, the purchase date. Tr. at 31:3950. In addition to the loans, in early 1973 Rubin and Berman stopped drawing salaries. In spite of these financial problems, or perhaps because of them, Rubin began designing in Fall 1972 two new pools, a low cost, above-ground pool in two sizes, named the Castle, and another above-ground pool, the Camelot. The Castle design was never completed, however, because of technical difficulties encountered by Royal's suppliers of aluminum extrusions in executing parts of the designs (Tr. at 20:2448–49) and because the unpaid suppliers were reluctant to cooperate with Royal. Tr. at 20:2461. In November 1972 Leonard Greenberg again approached Abe Berman at a swimming pool trade show and expressed interest in acquiring Royal. Berman promised to talk to him about the matter at a pool show they would both attend in January 1973. Tr. at 28:3621. At year end 1972 Royal was struggling. Rubin made the following assessment of Royal's financial condition as of December 31, 1972:

> We were not in good condition. We had an unbalanced inventory. We had suppliers that we owed a substantial amount of money to that were pushing us to get them money and at the same time, we were trying to work up ourselves different methods of trying to obtain capital.

Tr. at 20:2465.

January 1973 brought some relief in the forms of a $220,000 Small Business Administration loan and a $20,000 increase in Royal's loan from National Central Bank. Although this new capital was not sufficient to pay all of Royal's debts, it did start supplies flowing more freely to Royal from its main extrusion suppliers. Berman and Rubin projected total sales for 1973 as 1200 pools. In February and March, however, Royal's financial condition again worsened. Its inventory was high but out of balance. The imbalance was caused partly when Rubin was forced to substitute parts from other pool models for the parts of the Castle pool he could not, for one reason or another, get from his suppliers. Nor could Royal balance its inventory because its lack of capital discouraged suppliers from providing it with the parts it needed. This state of affairs is memorialized in the "Whereas" clauses of the Purchase Agreement:

> WHEREAS, ROYAL'S operations have produced a deficit for the twelve (12) month period ended January 1, 1973 of over One Hundred Seventy Five Thousand (175,000) Dollars; and

> WHEREAS, ROYAL'S operations have produced an additional deficit for the period ended March 31, 1973; and
> WHEREAS, ROYAL is in immediate need of additional working capital to continue its operations; and
> WHEREAS ROYAL is not presently able to obtain said additional working capital from any source;

Meanwhile Leonard Greenberg and Abe Berman had met at the pool show in January 1973. Greenberg told Berman that he thought it was time to sit down and talk about Coleco's acquiring Royal—"that he [could] make rich men out of us." Tr. at 28:3624. Rubin and Berman, exploring different avenues for providing Royal with much needed capital, agreed; eventually a meeting between Rubin and Berman and Leonard Greenberg was set to take place at the Royal plant in New Jersey on April 18, 1973.

B. *April 18, 1973 Through June 4, 1973*

On April 18, 1973, Leonard Greenberg did, in fact, spend the day at Royal in Pennsauken. He talked to Rubin and Berman both separately and together. He collected information on Rubin's and Berman's backgrounds, and Rubin showed him around the Royal plant where Greenberg was impressed with the efficiency and orderliness of the packaging and shipping operation as well as the general design of the pool models. He noticed an apparently obvious discrepancy between the large amount of stock on some pool parts and the relatively small amount on others, and this observa-

tion triggered a discussion between Rubin and Greenberg on the problem of Royal's inventory imbalance. Tr. at 20:2510. Rubin and Berman discussed with Greenberg their increasing difficulty in getting parts because of lack of capital, and Rubin told Greenberg that in addition to any purchase price which Coleco paid for Royal it would have to pay out a substantial amount almost immediately to pay suppliers. Tr. at 20:2514. Berman told Greenberg that the crux of Royal's problem was that although the orders were coming in, Royal lacked the capital necessary to start a strong flow of pools from Royal to fill the orders. Tr. at 28:3625–26. Greenberg asked if Royal could produce and sell 2500 pools in 1973. Rubin said such production would be possible with a substantial infusion of capital,[10] operating two 10-hour shifts six days a week, and if Coleco provided Royal with production foremen. Tr. at 20:2514–15. Greenberg said money and personnel would be available and suggested further that Coleco could ease Royal's burden by providing Royal with certain Coleco-manufactured pool parts and with trucking services. Tr. at 20:2515–16. He also pointed out that should Coleco acquire Royal, suppliers would not press as hard for payment, because of the Coleco name. Tr. at 20:2515. Rubin told Greenberg that he believed Royal to be making an average $500 gross

10. Berman and Rubin both testified that Rubin told Greenberg that in order for Royal to produce 2500 pools in 1973, Coleco would have to invest $200,000 immediately and up to $500,000 within a few months to pay suppliers. Tr. at 20:2515 & 28:3629.

profit on each pool sale which would result in $4 million total sales for 2500 pools and a gross profit of $1,250,000. See Ex. U–14 at 4. There was also discussion among the three men of Royal's inroads and potential inroads on the dealer/customers of Abco Swimming Pool Co., a subsidiary of Coleco. Greenberg pointed out that one advantage of the acquisition would be the elimination of competition between Abco and Royal. Tr. at 20:2507. Greenberg testified on cross-examination that on April 18, 1973, he was aware that Abco and Royal shared some of the same customers and that Royal was courting one of Abco's larger customers. Tr. at 8:872–73. Finally, Greenberg told Rubin and Berman that Coleco wanted to acquire Royal because

> It would be an extension of the swimming pool—their participation in the swimming pool field on a high quality pool which they had not made before and he said that they had the choice of either designing it themselves from scratch or buying someone that was in the industry and it looked like we had been doing fairly well.
>
> He mentioned that he had been impressed the first—back in San Antonio a year ago with Abe's presentation of the booth and he watched us in the year in between and it looked like that we had done rather well for our limited capital, which was generally pretty well known in the field. . . .

Tr. at 20:2511. The three men then discussed a purchase price of approximately $1 million (Tr. at 20:2512), and Greenberg con-

ditioned his tentative offer on Royal's allowing Coleco personnel to visit Royal and examine its books and records. Tr. at 20:2513.

The substance of this April 18th meeting is corroborated by exhibit U–14, a memorandum, dated April 20, 1973, from Leonard Greenberg to Arnold Greenberg and Mel Gershman; the two Greenbergs and Gershman formed Coleco's executive committee. Some of the more salient portions of the memorandum document Coleco's motivation, as expressed by its then president, in acquiring Royal and Coleco's recognition that the acquisition was a speculative one. Greenberg begins the memo:

> Remembering, of course, that this company has yet to make a profit, the question really gets down to what management capability are we buying, and how is this evidenced by their product line, and what would it take for us to duplicate this type of product line and sell it.

He also suggests that Coleco could, upon acquisition, raise the price of each Royal pool about $200 since "they [Rubin and Berman] entered the market a little nervous this year, and let their pants down with regard to prices." Near the end of the memo Greenberg states, in discussing a purchase price,

> At this point I'm holding out for a million dollars and I have a hunch that they would be willing to sell for a million, and I stress, of course, in these notes, that they have still to show their first profit. Everything is conjecture.

In addition to Leonard Greenberg's April 20th memorandum, the record contains a memo, dated April 19, 1973, from Gershman to the Greenbergs. This memo (Ex. U–304) contains information which Gershman had collected at Leonard Greenberg's request in order to verify Royal's reputation and status in the swimming pool industry. Through discussions with the principals at Esther Williams Swimming Pool Co., Gershman did indeed verify that Royal was "undercapitalized and, therefore, couldn't really move in the marketplace because it takes so much money to build the inventory and carry the accounts" but that Hank Greenberg of Esther Williams (no relation to Leonard and Arnold Greenberg) said

> that Royal pool was coming up very strong, with apparently a good product copied after Esther Williams, and was in his second year. He indicated that both Berman and Rubin seemed to know what they were doing and that because of their limited finances he had to work carefully with them but indicated an estimated sale of 2500 filters this season.

Gershman also notes the "drastic material costs increases" in the pool industry in 1973 and that aluminum prices, in particular, were "increasing very rapidly." [11]

Before moving on in our narrative of the events of April and May 1973, we note that

11. Gershman testified in deposition, parts of which were read into the record at trial, that, as Coleco's overseer of purchasing, he was in a position to follow price fluctuation in the supplies market. Tr. at 19:2307.

plaintiff at trial and in its brief made much of two letters (Exs. 33 & 37),[12] dated April 17, 1973, and written by Joe Rubin to his two major suppliers of aluminum extrusions, Howmet Corp. and Capital Products, Corp. Rubin admits that he did not mention these letters to Leonard Greenberg during their April 18th meeting. Based on this omission, plaintiff contends that Rubin deliberately concealed from Greenberg the facts to which Rubin attests in the letters. In both letters, but especially in the letter to Howmet, Rubin invokes the imminency of Armageddon if both suppliers do not deliver as promised. He mentions various "disasters" and "catastrophes," including lost customers, damaged reputation, and threatened law suits, all resulting in no small part from the dereliction of Howmet and Capital. Rubin explains these letters and his failure to show them to Greenberg as attributable to the inflated rhetoric and factual exaggeration necessary in "a business letter that was sent out trying to shake them up into manufacturing parts for us correctly." Tr. at 24:3057. We accept Rubin's explanation and find that on April 18, 1973, Rubin and Berman represented to Leonard Greenberg the condition of Royal as they believed it to be.

On April 21, 1973, the Greenbergs and

12. Both exhibits were admitted as to defendants Rubin and Berman; we took under advisement the objection of the Cohen defendants that the letters, relevant only to the 10b–5 claim, were irrelevant as to them since we had already directed a verdict in their favor on the 10b–5 claim. We now sustain their objection.

Gershman met among themselves in Hartford to discuss the details of a possible acquisition of Royal. Although they were aware that Rubin and Berman wanted to effect any acquisition as rapidly as possible because of Royal's need for working capital, the Coleco principals, especially Arnold Greenberg, wanted a full audit as of June 30, 1973, to verify the $500 per pool gross profit figure Rubin had given to Leonard Greenberg. Tr. at 2B:26–28. This, in Arnold Greenberg's estimation, would delay closing until August 1973. Tr. at 2B:30. Should this take place, however, the Greenbergs and Gershman agreed they would pay $1 million for Royal over a three-year, payout period. Tr. at 2B:30.

One week later, April 28, 1973, Rubin and Berman came to Hartford and met there with Arnold and Leonard Greenberg, Mel Gershman, Michael Schwefel, Coleco's general counsel, James Hubert, Coleco's corporate controller, and Edward Fiałkowsky, Coleco's treasurer. The meeting was a lengthy one beginning with a discussion of Rubin's and Berman's backgrounds and the nature and status of the Royal operation. Although Rubin and Berman were enthusiastic about Royal's potential, they told the group at the meeting, as they had told Leonard Greenberg on April 18th, that Royal had to have an immediate infusion of several hundred thousand dollars of working capital for suppliers.[13] Tr. at 21:2527–

13. Rubin's and Berman's testimony that they talked, in the early discussions with Coleco, about Royal's need for an immediate few hun-

28. The conversation also covered the availability of Coleco foremen, pool parts, and trucking (Tr. at 21:2532 & 2535–36), as well as joint Abco/Royal customers and customers that Royal would bring to Coleco. Tr. at 21:2529. Rubin discussed the problems he was having with his newest pool model, the Castle. He told the Coleco representatives that he was having technical problems with the aluminum extruders because of their difficulty in executing his designs and that he had no final costing figures on the Castle. Tr. at 21:2531. He also told them that because of difficulties with suppliers he was shipping pools to dealers short parts when the dealers were willing to accept incomplete pools temporarily and wait for missing parts. Tr. at 22:2708–11. The Coleco representatives then told Rubin and Berman that before closing they wanted a June 30, 1973, audit. Rubin and Berman responded that Royal

dred thousand dollars for suppliers and up to $500,000 within a month or so appears corroborated by exhibit U–302, notes taken by Arnold Greenberg during the April 28th meeting in Hartford. The exhibit shows the following notation:

Suppliers: 300,000 now
will go to 400–500,000—by end of May

Although Arnold Greenberg testified that these figures represented Royal's total indebtedness to suppliers (Tr. at 3:166), the congruence between Greenberg's figures and the ones testified to by Berman and Rubin coupled with the presence in Greenberg's notes of the word "now" underscored persuades us that Greenberg was recording statements by Rubin and Berman that Royal would need several hundred thousand dollars by June to pay suppliers.

could not wait that long for relief. This seeming impasse was resolved when the parties tentatively agreed that the non-contingent $1 million purchase price originally contemplated would be reduced to $500,000 with another $500,000 contingent upon the profitability of Royal over a three-year period. As Arnold Greenberg put it: "In other words, if we were to be persuaded to go forward without a June 30 audit, they ought to wait for their money." Tr. at 2B:58. The parties also agreed that the Royal shareholders would warrant Royal's financial and operational status in the purchase agreement and that Royal's accountant, Zelnick, Sobelman, & Co., would prepare an unaudited April 30, 1973, financial statement also to be warranted in the Purchase Agreement. Finally, since Berman was reluctant to open fully his customer files to Coleco without some assurance that the acquisition was being seriously considered, the parties agreed that Coleco would provide Royal with a letter of intent to purchase, and plans were then made to send a team from Coleco to Royal

> to take a look around, to get some comfort, to take a look at certain books and records to see if they backed up the recommendations we heard.

Tr. at 2B:77 (Arnold Greenberg).

The examining team, consisting of Schwefel, Hubert, and Gerald Glassman, Coleco's then director of costing,[14] subse-

14. Although Glassman is no longer in the employ of Coleco, we consider his deposition testimony, read into the trial record, to be crucial

quently visited Royal on May 2, 1973. Schwefel, who brought with him the letter of intent, spent a good deal of time with Berman going over the status of Royal's individual dealer/customers. Tr. at 21:2599 and 28:3642–45. Berman told Schwefel about Royal's practice of giving customers so-called "protected territories," that is, making informal, usually oral agreements that Royal would not sell pools to other dealers in a certain geographical area. Berman considered these agreements a common practice in the swimming pool industry, terminable at will, and without any legal force. Tr. at 28:3616–18. Schwefel told Berman he was familiar with the concept of "protected territories" through Abco, Coleco's subsidiary, which also engaged in the practice. Tr. at 29:3738–40. Berman also discussed with Schwefel special problems with Regency, Carib, and Style, all pool companies.[15] Tr. at 28:3643–

for a few reasons. First, he was, both during 1973 and at the time of his deposition, plaintiff's own man, one of its higher ranking management employees. Tr. at 3:242. Second, as Coleco's director of costing, he was its expert in the area in which Coleco claims perhaps the most serious breach of the Purchase Agreement. We also note that despite Glassman's significant role in pre-acquisition activity, plaintiff did not call him as a witness.

15. Regency was an apparently abortive enterprise Rubin and Berman launched in 1972 to distribute Royal pools in Canada. Tr. at 28:3643. Regency was to be operated in Canada by a Mr. Gascoigne and a Mr. Mitchell who were to receive a commission on each Royal pool sold in Canada whether or not they sold it. Tr. at 27:3529–30. Rubin showed the contract with Gascoigne and Mitchell to Schwefel, and

47. In addition Schwefel sat in on a discussion between Berman and Royal's attorneys concerning litigation with Carib Pool Co. in which Royal was involved and went over the Royal shareholder and bank loan agreements. He asked to see customer service files, and Rubin told him that no files existed since service complaints were minor, usually having to do with faulty liners and were dealt with informally.[16] Tr. at 4:304–

Regency was discussed with Schwefel on more than one occasion. Tr. at 27:3531–32.

Carib was the pool company involved in litigation with Royal in the Spring of 1973. The lawsuit was settled in May 1973.

Style Pool Company was one of Royal's 1972 dealer/customers in Chicago. Style had purchased about 25% of Royal's production in 1972, but Rubin and Berman had had a great deal of difficulty in collecting their money from Style, nearly $100,000 owing to Royal near the end of 1972. In order for Royal to collect its money, Rubin and Berman were pressured into entering into a written agreement with Style in October 1972 giving it an exclusive distributorship. When they finally collected all money owing from Style, they notified Style that Royal would no longer deal with it. All this information was revealed to Schwefel on May 8, 1973. Tr. at 28:3644–47.

16. We have not overlooked exhibit U–77, a letter from Style to Coleco dated June 6, 1973, and exhibit P–82, a memorandum from Tony Gaeta to Abe Berman dated June 18, 1973, in finding that Royal had had no major customer complaints prior to June 4, 1973, and that whatever complaints it had received were handled informally. Both U–77 and P–82 are, of course, dated post June 4, 1973. As to the substance of the problems cited in U–77 and P–82 and relevant to the inferences one might draw regarding the kinds and number of cus-

5. Hubert spent his time with two of Royal's accountants, Norman Zelnick and Steven Savett, going over their work papers for a January 31, 1973, financial statement they had prepared for Royal.[17] Based on information given to him, Hubert then prepared an estimate of Royal's profits for 1973. Glassman spent his time either with Rubin or alone going over invoice files and

tomer complaints Royal might have received prior to acquisition, we note first that complaints from Style to Coleco are suspect given the difficulties it had created for Royal in 1972. Rubin believed Style to be capable of commercial blackmail, and, although Style no longer dealt directly with Royal, it was still a customer of Coleco's. Second, while Gaeta's assertions in P–82 are not suspect, most of the complaints he lists go not to the quality of the Royal pools but to Royal's failure to deliver promptly on the orders it took. This, of course, is the problem, revealed to Coleco prior to acquisition, that prompted defendants' decision to sell Royal. Gaeta also mentions the related problem, also revealed to plaintiff prior to acquisition, of Royal's shipping incomplete pools to dealers who were willing to accept them that way temporarily. Finally, Gaeta cites complaints for faulty liners and Royal's failure to deliver a pool feature called "Roman Steps." Rubin told Schwefel prior to acquisition that most of the complaints he had received had to do with faulty liners. As for the missing "Roman Steps," whatever the explanation for the problem to which Gaeta refers, his memorandum reference does not move us to change our finding that Rubin spoke the truth when he told Schwefel that he kept no formal customer complaint files and that he dealt with occasional minor complaints on an ad hoc basis.

17. Hubert found a $16,000 error in the statement which was corrected in the April 30, 1973, statement. Tr. at 10:1107–09.

a cost sheet and bills of material on the different pool models made available to him.[18] Glassman toured the factory with Rubin and noted that the Royal inventory was "very much out of balance," (Tr. at 19:2255) and he and Rubin discussed the problem. Rubin then showed him the cost sheet[19] on the 15 by 30 foot Crest pool, Royal's largest seller for 1972. Eventually, Glassman found that $70 worth of materials had been left off this cost sheet.[20] Tr. at 19:2259 and 2283. Although Rubin did not show him cost sheets on other pools, he showed him the bills of material[21] for several other pools but not the Castle and Camelot models, and Glassman found the same items missing on these bills of material as he had found on the Crest cost sheet. Tr. at 19:2267. Rubin and Glassman also discussed the fact that Royal's cost sheets had not been updated from 1972 and that aluminum prices were rising. Tr. at 19:2284. Rubin estimated the price rise

18. Glassman's account of his visit to Royal on May 2, 1973, and Rubin's account of the same visit are highly corroborative.

19. A cost sheet consists of a listing of the various parts comprising a given pool model along with the prices of the parts.

20. Hubert testified that after Glassman informed him of the $70 discrepancy, he ascertained from Rubin that $20 of the $70, the cost of a crate, was accounted for since it was included in factory expenses rather than in the cost of the pool. Tr. at 10:1112.

21. A bill of material differs from a cost sheet in that it omits prices.

would affect the price of a pool by $50. Tr. at 19:2284. Finally, near the end of the day, Rubin discussed with Schwefel, Hubert, and Glassman together the problems caused by inventory imbalance, particularly the problem of shipping out Castle pools with heavier and more expensive Crown and Crest parts substituting for the missing Castle parts. Tr. at 21:2567–68. After this meeting at Royal, Glassman discussed his findings at Royal with Hubert and Schwefel. He summarized those discussions this way:

> Only to the effect that I was satisfied that the items listed on the Bills of Material or the Bill of Material, if you will, were costed properly according to invoices, but that I did have a concern that perhaps there might be other items that I didn't find inasmuch as I had found some $70 of items already just by probing that were not contained on the Bill of Materials.

Tr. at 19:2283. Back at Coleco, Glassman told Mr. Gershman about the discrepancies he had found:

> I informed him of the missing items on the Bill of Materials. I told him that I had been satisfied that the pricing that had been listed on the costed Bill of Materials appeared to be correct, and I expressed a concern about perhaps some other items that I didn't find listed that perhaps might also be missing from the costing.

Tr. at 19:2294. Glassman and Gershman discussed Royal's inventory imbalance. Tr. at 19:2300–01. Glassman also reported his

May 2nd findings directly to Arnold Greenberg.[22] Tr. at 19:2296. Stangely enough, although Schwefel visited Royal again and Hubert twice more prior to acquisition, Glassman was not again instructed to concern himself with Royal until September 1973. Tr. at 19:2296–97.

Sometime after May 2, 1973, Schwefel called Royal to say that Coleco was willing to go ahead with the acquisition and that he was sending to New Jersey a copy of a draft agreement. The upshot of this call was the next meeting between Royal and Coleco in Hartford on May 14, 1973. This time, however, Rubin and Berman met only with Schwefel and Hubert, Arnold Greenberg coming into the room only a few times to engage in a quick exchange and then leave. Beginning a pattern of practice followed by Coleco through the critical Summer of 1973, Schwefel conducted the direct communications between Rubin and Berman and Coleco. The parties once again discussed joint Abco/Royal customers (Tr. at 24:3094), Royal's need for a large infusion of capital (Tr. at 21:2618), its inventory imbalance (Tr. at 21:2618), and its special relationships and problems with Regency, Style, Carib, and Apex pool companies (Tr. at 21:2602–03).[23] Berman and Rubin were

22. Greenberg does not dispute that Glassman reported to him; he testified only that he has no recollection of such a report. Tr. at 3:249.

23. Apex was a New England pool company connected with Carib pools. Berman considered Apex to be Carib's dealer and that any exclusivity afforded Apex came though Royal's relationship with Carib. As Berman put it,

unhappy about unilateral changes they felt Coleco had made from their original understanding to the draft agreement and were offended by the Greenbergs' seeming refusal to deal with them directly. Before leaving Hartford, however, Rubin did telex banks and certain of Royal's suppliers authorizing them to release to Coleco's representatives financial information they had on Royal. Tr. at 21:2618–19. In addition, before they left, Arnold Greenberg stopped in the meeting room to say that the litigation with Carib pools must be resolved before closing. Tr. at 21:2623. Within several days after this May 14th meeting, Schwefel called Royal to inquire into the status of the acquisition, and Rubin and Berman told him that they had decided against going ahead because of the discourteous treatment they had received in Hartford on May 14th. This announcement precipitated a phone discussion between the Greenbergs in Hartford and Rubin and Berman in Pennsauken during which agreement was again reached. Thereafter, Hubert visited Royal twice more on May 25, and June 1, 1973, to work with Royal's accountants on the April 30, 1973, statement which was to be war-

"Carib had an exclusive and Apex had an exclusive with Carib and I honored that and let Apex know about that." Tr. at 29:3746. The Apex situation was discussed with Schwefel more than once. Tr. at 21:2605–07 and 28:3664. On May 14, 1973, in Hartford, when Berman explained Royal's relationship to Apex to Schwefel, he told Rubin and Berman that, in his opinion, Apex was Carib's dealer and not Royal's. Tr. at 21:2606.

ranted as part of the Purchase Agreement, and reported back to Hartford. Although Hubert had, over his several visits to Royal, discovered more than one error made by Zelnick, Sobelman, and Co., he missed two others that defendants concede render the April 30, 1973, statement erroneous in the amount of $49,922.88.[24] At last, on June 4, 1973, the Carib litigation having been settled, the acquisition was effected and closing took place in Pennsauken and Philadelphia. The Royal shareholders received $135,000 plus interest as the first of three non-contingent payments, and Coleco took Royal.

To summarize, then, and to make explicit our assessment of the character of Rubin's and Berman's negotiations with Coleco which culminated in the June 1973 acquisition of Royal by Coleco, we find that during the whole of the pre-acquisition negotiations, both Rubin and Berman were forthright in their dealings with the principals and representatives of Coleco and did not deliberately misrepresent any aspect of Royal's status or operation. Any factual misrepresentation made through the vehicle of the warranties in the Purchase Agreement, especially through the warranty of the April 30, 1973, financial statement, was not studied.

24. Post-trial brief of the Cohen defendants at 2. Zelnick, Sobelman, & Co. admits these errors were accountants' errors. Tr. at 31:4072–76 and 4085.

C. *June 4, 1973 Through November 1973.*

Immediately upon closing and continually thereafter Berman, and especially Rubin, applied to Coleco, through Michael Schwefel, for the heavy infusion of capital to suppliers they had been led to expect would be forthcoming. Tr. at 21:2657–67. It simply never came. In June Coleco advanced $155,000, in July $45,000, and in August $9,000 to pay suppliers. Tr. at 3:226. The continuing shortage of working capital had three immediate effects. It left suppliers unsatisfied so that they withheld materials from Royal.[25] Tr. at 21:2659–70 and 28:3673–74. This, in turn, precluded Royal from delivering on its orders and from balancing its inventory. *Id.* Finally, it made Royal's accounts receivable difficult to collect for reasons on which Berman and Anthony Gaeta, a Royal salesman, agreed. Tr. at 28:3674–75 and 30:3844–45. As Gaeta explained the problem:

> The reason I was having a problem is that at that time of year, the manufacturer is in a very critical position. The dealer has sold his pool. If he does not receive delivery, the customer is going to cancel, so the dealer will go somewhere else. In order for the dealer to go somewhere else at that time of the season, he had to pay cash or certified before delivery so he would hold up the monies that he owed me to pay another manufacturer.

Tr. at 30:3844–45. This situation left Rubin contending daily with suppliers to obtain what parts he could (Tr. at 21:2673) and Berman contending daily with dealer/customers on whose previously obtained orders he could not deliver. Tr. at 21:2668–69. Nor did Rubin ever get any Coleco personnel to help him in the factory, and for seven weeks during the summer of 1973 he worked seven days a week, 13 and 14 hours a day. Tr. at 22:2698 and 2702. Moreover Berman and Rubin were relegated to dealing with Schwefel, Coleco's general counsel, in trying to work out Royal's operational problems. Schwefel told Rubin to deal through him (Tr. at 21:2646–47), and, when Rubin attempted to contact directly Mel Gershman, Coleco's overseer of purchasing, he was unsuccessful. Tr. at 21:2666.

Aside from preventing Royal from producing the number of pools Coleco wanted it to produce, the frustrating state of affairs in Pennsauken had a second debilitating effect. Berman and Rubin were fast alienating each other. Berman obtained many more orders than Rubin could fill so Berman was constantly importuning Rubin for more finished pools. Rubin, in turn,

25. The situation with suppliers was exacerbated because, just prior to closing, Rubin had released to suppliers news of the acquisition and had thereby raised their expectations of payment, as the Greenbergs had predicated. Tr. at 21:2657–58. When payment was not forthcoming, suppliers took a hard line toward Royal. Rubin told Hubert:

> We have no answer for suppliers. Coleco came on like a big company and said they were going to pay everyone and the suppliers want money and now they refuse to give us anything.

Tr. at 21:2665.

without the foremen Coleco had promised and instructed by Schwefel to use Berman in the factory (Tr. at 22:2698), attempted to draft Berman into production. At this Berman balked saying to Rubin:

> What am I going to do out there? I don't know how to drive a fork lift. I don't know how to pack a pool. I wouldn't know if parts were short and what parts weren't short. I am a salesman. I am selling pools. I've got the pools sold and now it is up to you to ship them.

Tr. at 26:3442. Berman also left the office work and supervision of the office workers to Rubin. Tr. at 26:3428, Ex. R–35. For instance, in a letter to his counsel that Rubin wrote in September 1973, he made the following statement which we credit:

> Berman never Credited dealers on returns. He never Debited suppliers on returns. Generally the office work was a disaster. . . .

Ex. R–35 at 4 (admitted without objection). By July Rubin was keeping a diary of Berman's comings and goings and reporting them to Coleco (Ex. 18). Berman told Rubin that "he will do what he wants and let Coleco fire him then he will sue." Ex. 18, Tr. at 26:3439. This statement was part of the information that Rubin relayed to Coleco. Tr. at 26:3439. In addition, Rubin testified at trial that Berman spent less and less time at Royal in July but that he didn't know whether Berman spent his time away from Royal on personal matters or on Royal's business. Tr. at 26:3429. According to Berman and Gaeta, whose testimony we accept, the bulk of the time away from

Royal was spent on telephones with and at the premises of dealers/customers trying to placate those whose orders were overdue. Tr. at 22:3689–92 and 30:3845–46. Also in July Coleco made known to Rubin and Berman that it was considering adding Al Katz to Royal's sales staff. Berman objected strongly, first, because he disapproved of Katz's sales techniques, and, second, because he felt that Royal, heavy on orders and light on production, needed no addition to its sales staff. Tr. at 28:3679–80–81. In spite of Berman's strong objections, Leonard Greenberg announced to Berman at a meeting in Hartford on July 14, 1973, that Coleco had hired Al Katz as Royal's sales manager. At the same meeting Berman presented a 1974 sales projection considered unrealistic by the Coleco personnel and by Rubin, whose opinion we accept. Tr. at 26:3434–36. Shortly thereafter Schwefel instructed Rubin to inform Berman that he was no longer President of Royal, and Rubin transmitted the message. Tr. at 28:3698–99. Next, Coleco informed Berman he would no longer have authority to sign checks for Royal. Tr. at 28:3700. Then sometime at the end of July or the beginning of August, Rubin told Berman that Leonard Greenberg had requested Rubin to keep a log on Berman and to tell Berman he was doing so. Tr. at 27:3466 and 28:3704. At this point Berman left Royal and was gone a few weeks. He described his reaction when Rubin told him about the log this way:

> The fact that the money—we didn't have the money to buy materials, that we

couldn't supply pools, that they took the presidency away from me, that they took the check signing authority away, the way I was treated up in Hartford, this [Rubin's telling him about the log] was more or less the straw that broke the camel's back. I just felt my heart palpitating, my stomach turning over and my face turning red, and I said to Joe, "Joe, I'm sorry; because of what's going on here, I must get out of here."

I left and sat down with my wife and told her what happened and she immediately called the doctor and we went over to see him and as a result of this I called Joe and told him that I must have time off, I did go to see a doctor; I must have time off. Otherwise, it is going to result in a nervous breakdown and that I was going away to the seashore for a few days; that I will be in touch with him and as soon as I am able to return, I certainly will, which should be approximately two weeks.

Tr. at 28:3705–06. During the time Berman was away from Royal, he missed an executive meeting in Hartford which he was supposed to attend. Shortly after he returned Arnold Greenberg informed him by phone that he was discharged. Coleco also notified him formally by letter (Ex. 146).

Meanwhile Royal was struggling through the Summer with suppliers dunning them for payment and dealers clamoring for pools. An inventory was taken [26] at the end

26. The taking of the inventory produced added difficulty between Rubin and Berman. Rubin

of July, badly taken according to Rubin (Tr. at 22:2732–36) whose opinion we credit, and Coleco personnel contended that based on the figures Royal had given them at closing, they had come up short. At approximately the same time as the taking of the inventory Gershman issued a memorandum (Ex. R–49) cancelling all orders with suppliers and authorizing new purchase orders only for materials "to balance off and complete 320 pools." According to Rubin's testimony, which we credit, this directive increased the chaos at Royal:

> With regard to paragraph 3, I asked, "What model 320 pools are we supposed to build?" With regard to paragraph 2, I asked, "Why are we cancelling orders that were placed in an effort to balance out the inventory and then issue new orders for 320 pools that I didn't know what models they were referring to?" It just didn't seem to make any sense. . . . In some cases, it didn't make any difference because vendors had refused to ship us for lack of payment, so cancelling was a futile gesture and in other cases when we cancelled it threw out of balance what we were trying to balance out.

Tr. at 22:2730–31. Yet, in spite of the results of the inventory and the directive from Gershman, on August 16, 1973, Leonard Greenberg wrote to Rubin after an August 13th meeting in Hartford:

> tried to involve Berman in the inventory. Berman at first demurred on the ground that he must deal with anxious customers and then, on the next day at Schwefel's or Hubert's request, lent some assistance.

> Let's all put our shoulders to the marketing wheel now. I think we know what we have to do for next year, and I think we have an excellent opportunity to grow successfully.

Exhibit U–83 at 4. Also in August Royal received a handful of complaints (less than 10) that Castle pools had pulled apart or "blown" in the field. As a result Rubin designed a "retrofit kit" (Tr. at 22:2760), an assembly to be added to the structure of the pool to prevent any further problems.

In September Abco, Coleco's subsidiary pool company, began to take over the Royal sales functions. The situation with suppliers was as bad or worse than ever. Rubin told Schwefel and Hubert "that they will not open for business in 1974 unless they pay suppliers." Tr. at 22:2772. A letter dated September 25, 1973, from Rubin to Leonard Greenberg (Ex. U–94) records Rubin's assessment of Royal's problems with its accounts payable. After noting that relations with Howmet were excellent, that Howmet was willing to wait for its money, and that he did not intend to deal with Capital, Rubin went on to say:

> On the balance of suppliers we are having major problems. These are small operators that require money immediately. I have not been able to find anyone at Coleco that will give me a clear financial picture at this time and it has placed me and Royal in a very poor position as far as negotiating with these suppliers. I had hoped that when I sent my Aug. 27th letter to Ed Fialkowsky that the picture

> would clarify itself since it covered in total, our fourth quarter budget plus cash flow plus receivables plus expenses. However, neither Hubert nor Fialkowsky have at this point been able to give me information as to when monies would be available. I have been told on an unofficial basis that everyone would be paid by Dec. 15th, but this was not definitive enough for me to clearly negotiate with the suppliers. As a result, our credibility factor has been questioned and probably some of the suppliers will not be willing to do business with us next year. If the target date is Dec. 15th and I definitely know about it, at least I know where and how to act. However some monies must be paid prior to that date as some suppliers absolutely cannot wait.[27]

27. Exhibit R–6, a portion of which was admitted in evidence over objection (Tr. at 22:2780–84), offers some corroboration for Rubin's statement to Leonard Greenberg. In exhibit R–6, a September 6, 1973, letter to Rubin, the president of Jard Engineering Co., one of Royal's suppliers, wrote:

> Like all our other customers, we value the Royal account, but upon a closer examination, we find that even though your account represents a large dollar volume, it has not been profitable for one apparent reason. During the month of August alone, we paid $774.05 in interest charges to borrow money to equal the amount that Royal currently owes us.
>
> In as much as Jard is not a large company, we can not afford to continue to finance Royal or Coleco. We, therefore, have no alternative but to charge a 1½% per month service charge for all invoices over thirty (30) days old.

Exhibit U–94. He received no response from Coleco to his letter. Tr. at 22:2779. In September the communications lines between Rubin and Coleco remained down. Tr. at 22:2785. On September 27, 1973, however, Rubin attended a meeting in Hartford with the Greenbergs, Gershman, and Schwefel. During the course of the meeting, Leonard Greenberg told Rubin that the manufacturing of Royal's above-ground models was to be moved to West Haven, Connecticut. Tr. at 22:2797. Since most models of Royal pools were above-ground models, such a change would, in Rubin's words, render the Pennsauken facility a "hollow operation." Tr. at 22:2798. When the Coleco men asked Rubin if he wanted to move to West Haven, he responded negatively and invoked the clause in his employment contract which stipulated that Royal's operation would not be moved more than 30 miles absent an agreement of the parties. Tr. at 22:2798. He then asked what would comprise his duties at Royal in New Jersey after the move but received no answer before the meeting adjourned. Tr. at 22:2798. Just before adjourning Arnold Greenberg told Rubin that Coleco was "going [to go] after the Cohens . . . and Abe Berman" if necessary by a lawsuit. Tr. at 22:2799. He told Rubin he was satisfied with his work and would

As of the writing of this letter Royal owed Jard $62,943.01, of which $51,088.25 was owing more than thirty days. Although plaintiff raised hearsay objections to exhibit R–6, plaintiff does not contend that the facts represented by Jard are inaccurate. Tr. at 22:2782.

like to retain and protect him; Greenberg asked Rubin if he would testify for Coleco in a lawsuit. Tr. at 22:2800. Rubin responded that he would simply testify to the truth. Tr. at 22:2800. Back in Pennsauken, Royal employees were being given their working instructions directly by Coleco representatives, a method of operation that bypassed Rubin. Tr. at 22:2810.

In October Rubin received a memorandum, dated October 17, 1973, from Gershman (Ex. R–135) in which Gershman informed Rubin that he was to complete packaging the 150–200 pools for which he had parts on hand. Gershman went on to say:

> We would suggest that you, Joe, then personally sell off these Royal pools so that Abco will not get involved in cleaning up the pools from your stock.

Following receipt of this memorandum Rubin procured an order from a pool dealer, Eugene Margolis, for 300–400 Castle pools. Tr. at 22:2820. When Rubin notified Coleco of the sale, however, Schwefel told him not to contact Margolis again, and Hubert later told him Coleco never sold the pools to Margolis. Tr. at 22:2821. Sometime in November Rubin came upon an advertisement in a trade journal (Ex. R–152) that, for the first time, informed him of the use to which Coleco was putting the Royal name and reputation. The advertisement is headed:

> This year ABCO is also ROYAL
>
> the Famous Line of
> ALL ALUMINUM SWIMMING POOLS

A portion of the text of the advertisement states:

> Royal pools have always had a great concept. Now, this outstanding line will have Coleco for manufacturing and inventory control and ABCO's management and distribution experience . . . an outstanding combination.

The company name is printed as "ABCO/ROYAL (a subsidiary of Coleco Industries, Inc.)," and the pools pictured in the advertisement are called the Crest, the Jewel, and the Crown. Up to the time he saw the advertisement, Rubin was unaware of any connection between Royal and Abco except for Abco's acting as Royal's sales department; nor was he informed that the Royal Crest and Crown names were to be appended to Coleco's apparently newly-designed versions of above-ground aluminum pools.[28] Tr. at 22:2823–29.

28. On direct examination Rubin testified that the Abco/Royal Crown and Crest were constructed of sheet aluminum rather than the extruded aluminum used in Rubin's designs. Tr. at 22:2827. His answers to questions also implied that he believed the new Crown and Crest to be redesigns of the old Crown and Crest. Tr. at 22:2828–29. On cross-examination Rubin further testified that the technical design and construction of the new Crown and Crest appeared different from that of the old ones. Tr. at 27:3594–97. When counsel for plaintiff attempted to elicit Rubin's agreement that there was no redesign involved, Rubin answered:

> It may be partially correct or incorrect. I don't know. Maybe the fencing is the same. Certainly the balance of it is not. It was just a partaking of the name.

By November 1973, then, Rubin found his professional situation totally unworkable. His relationship with Coleco personnel was "absolutely terrible;" "there was not even a pretense on their part of attempting to work with me." Tr. at 22:2830. Rubin had one last meeting with Arnold Greenberg, who reassured him that any slights or failure to transmit information was inadvertent on Coleco's part; he also asked Rubin to meet him at a trade show in New York near the end of November. Tr. at 22:2834–35. Rubin went to the show but never saw Greenberg. Tr. at 22:2836. He then came back to New Jersey and typed and mailed his resignation. (Ex. R–154).

Having concluded our chronological factual findings, we now come to the question of what happened to Royal All-Aluminum Swimming Pool Corp. during the Summer and Fall of 1973. According to plaintiff, Royal was doomed to failure before it purchased the company; the misrepresentation of Royal's financial status, the presence of exclusive dealerships, and the defective design of the Castle pool, all of which constituted breaches of the Purchase Agreement,

. . . . . .

> I can't answer that. I would really have to think considerably, because I think it may be misleading and a play on words, with no disrespect meant.

Tr. at 27:3595. We agree with Rubin that the problem appears semantic. Whether or not Coleco was attempting to bolster Abco's sales through the Royal name, the Royal design, or a combination of the two is not material. The point is that without informing Rubin, Coleco appropriated for Abco what it obviously perceived as Royal strengths.

precluded profitability, destroyed Royal's reputation and customer goodwill, and drove away customers. We simply cannot accept this contention. Assuming, for the moment, the breaches of the Purchase Agreement, which plaintiff alleges, we note, that with the exception of a breach of the financial warranty, Coleco offered no persuasive proof of money damages flowing from the existence of exclusive dealerships or from the problems with the Castle pool in August 1973. Neither did plaintiff prove loss of customers or reputation resulting from these breaches. In fact, in view of Coleco's obvious attempt to use the Royal name in trade journal advertising for the 1974 pool season to attract customers for Abco (Ex. R–152), it defies logic to find that Coleco believed Royal's reputation to be in ashes. Plaintiff in its post-trial brief states that what it was bargaining for in acquiring Royal was "a *potentially* profitable company producing and marketing a high quality product, with an established clientele and goodwill and having experienced and qualified executives to manage day-to-day operations." Plaintiff's post-trial brief at 113 (emphasis added). This, we find, is substantially what Coleco got. Royal failed, we find it much more probable than not, because Coleco mismanaged it after the acquisition.

To begin, it becomes clear, in retrospect, that Coleco did not invest in Royal the amount of working capital necessary to start the free flow of material that would have thrown Royal into high gear. This probably resulted from lack of planning on

one hand and miscalculation on the other. Gershman, one of the three Coleco principals and its overseer of purchases, admittedly made no projections or forecasts of the amount of working capital Royal would need in 1973 nor did he instruct anyone on his staff or in the accounting department to do so. Tr. at 19:2329–30. Nor did Gershman do any forecasting for the 1974 pool season. Tr. at 19:2330. In addition to problems caused by lack of planning, it appears likely that Arnold Greenberg's theory on how to handle suppliers backfired. Greenberg explained at trial that

> Our desire was to get as much supplier/company operation, obviously, without putting in—without putting in too much money and I think that was a significant piece of financial assistance. It was our goal to put in as much money as was required to meet the sales needs of Royal
>
> . . . .
>
> A supplier relationship is very often a continuous bit of dialogue, whereby the supplier would like more and the manufacturer of a seasonal product who has great needs and big receivables for part of the year says "yes, I know, but I need another 30 days."
>
> The part of the skill of a good businessman is to negotiate that and ease the need for cash input and yet allow the supplier to live. It is a delicate piece of business. I think we have generally been successful at it.

Tr. at 3:230–31. We do not believe Coleco was successful in the present case. There is also scattered but persuasive evidence in

the trial record that Coleco was having financial problems of its own during the summer of 1973 which diverted both Coleco's attention and money away from Royal. In June 1973, after acquisition, when Rubin questioned Schwefel about his reporting to Schwefel instead of directly to the Coleco principals, Schwefel told Rubin:

> Look, don't rock the boat. We have problems up there; we have problems in the Coleco organization. They are losing a lot of money in Canada. Just stay with it and don't rock the boat.

Tr. at 21:2672. In addition, Schwefel instructed Rubin to include in his report of June pool sales the pool sales from the first two weeks in July so that June, Coleco's quarterly closing, would "look like a big month." Tr. at 21:2677. Rubin complied.[29] Tr. at 21:2679. In September, responding to Rubin's requests for money to pay suppliers, Schwefel and Hubert said that "they were having major financial problems of their own and that they had no money to give us." Tr. at 22:2772. Finally, Arnold Greenberg testified upon cross-examination that Coleco did not show a profit in 1973 "by virtue of discontinuing an operation." Tr. at 3:274.

Furthermore, the Coleco principals, Arnold and Leonard Greenberg and Mel Gershman, apparently preoccupied elsewhere, insulated themselves from direct contact with Royal and especially from direct contact with Rubin, the man closest to Royal's problems. As we noted earlier, strange though it now seems, the Coleco representative to whom Rubin reported and answered was Michael Schwefel, Coleco's attorney, who made no pretense of having any working knowledge of the pool business. Tr. at 4:303. Thus, we will never know whether the decisions to limit supplier payments to a total of $210,000 for the pool season months of June, July and August and not to provide Royal with production foremen to aid Rubin were a product of studied consideration by the Greenbergs and Gershman, of hasty denial, or of the incompleteness or imprecision of the information filtered to them through Schwefel. Coleco's inattention to Royal in Summer and Fall 1973 is also evidenced by its failure to effect the price rise for each pool model obviously contemplated as early as Leonard Greenberg's memorandum of April 20, 1973 (Ex. U–14). Rubin advised Schwefel as early as June 1973 that a price rise was in order to "give us more working capital and at the same time slow down the influx of orders." Tr. at 22:2723. Yet by October 1973 the prices had not been changed. Tr. at 22:2797. The slowness of Coleco's moving to raise prices is even more curious when one recalls the testimony of Gershman and Glassman and Gershman's memorandum of April 19, 1973 (Ex. U–304), which record Coleco's awareness of the rising costs of pool materials, especially of aluminum. Finally, we note that although

29. Rubin's compliance is corroborated by exhibit R–96, a tally sheet Rubin kept, which shows the total pool sales for the month of June as including the sales for the first two weeks in July.

Arnold and Leonard Greenberg believed in April 1973 that one of Royal's greatest strengths was the two men who ran it, Rubin and Berman, they handled both men badly insisting that Berman, the salesman, work in the factory, and allowing Rubin to work killing hours unaided for weeks. Indeed, both men were gone by the end of 1973.

In summary, we believe that Royal's problems during 1973, which may have rendered it inoperational by 1975, did not result from Royal's inherent weaknesses but from Coleco's mismanagement of what it recognized from the beginning was a speculative venture into a fledgling business. Recall Leonard Greenberg's admonition in his April 20, 1973, memo (Ex. U–14): "Remembering, of course, that this company has yet to make a profit," and his statement in the same memo "Everything is conjecture." Furthermore, putting aside for the moment the reasons why Royal no longer operates, we note that Royal, in spite of its severe problems, broke even for the five-month period ending September 30, 1973 (Tr. at 12:1393), and that Abco, as distributor of Royal pools in 1974 and with its advertising leaning heavily on the Royal name, had a record year. Tr. at 9:990 (L. Greenberg).

II

CONCLUSIONS OF LAW

Again, in the interest of palatability, we will present our conclusions of law in essay form rather than in separately numbered

paragraphs. The following discussion, then, comprises our conclusions of law required under Fed.R.Civ.P. 52(a).

A. *Liability of Defendants Rubin and Berman Under Section 10(b) and Rule 10b–5*[30]

[1] To make out a 10b–5 case a plaintiff must prove that defendant made a misrepresentation either through affirmation or omission, with the requisite scienter, of a material fact upon which plaintiff relied. *Thomas v. Duralite Company, Inc.*, 524 F.2d 577 (3d Cir. 1975).[31] Recently in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976), the United States Supreme Court clarified the concept of scienter in the context of a 10b–5 action by holding that it did not encompass mere negligence. Relying on the language of section 10(b) itself, on the legislative history of the section, and on a comparative analysis of the two major securities acts, the Court stated that "[i]n this opinion the term "scienter" refers to a mental state embracing intent to deceive, manipulate, or defraud." *Id.* at 194, 96 S.Ct. at 1381 n. 12. The Court did go on to say:

> In certain areas of the law recklessness is

30. At the close of plaintiff's case, we directed a verdict on the 10b–5 claim for the Cohen defendants. Tr. at 18:2069–73.

31. In *Thomas*, the Court of Appeals for the Third Circuit holds, however, that in the case of misrepresentation by omission, the burden of proving non-reliance shifts to the defendant because of the difficulty for plaintiff of proving a negative. 524 F.2d at 585.

considered to be a form of intentional conduct for purposes of imposing liability for some act. We need not address here the question whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b–5.

Id. Given the thrust of *Ernst & Ernst*, however, with its emphasis on conscious manipulation and trickery, we feel confident in continuing to apply to the 10b–5 issues in this action the test for scienter which we applied in granting the Cohen defendants' motion for directed verdict before the Supreme Court handed down its decision in *Ernst & Ernst*. Accordingly, we hold that to establish the element of scienter in an action brought under section 10(b) and Rule 10b–5, a party must prove injury resulting from a conscious deception or from a misrepresentation so recklessly made that the culpability attaching to such reckless conduct closely approaches that which attaches to conscious deception.

[2] Applying, then, the legal principles articulated in *Thomas v. Duralite Company, Inc.*, and *Ernst & Ernst v. Hochfelder* to the facts of this case, we conclude that plaintiff has not proved that either defendant Rubin or defendant Berman violated section 10(b) and Rule 10b–5. Plaintiff alleges that both defendants violated the federal securities law in that they culpably misrepresented or failed to reveal the following facts during pre-acquisition negotiations:

1. That Royal lost a substantial number of customers from the 1972 to the 1973 selling season.[32]
2. That Royal had received serious complaints from customers.
3. That Royal was a party to territorial or exclusive selling agreements.
4. The status of Royal's relationship with material suppliers.
5. That Royal's inventory was out of balance.
6. That the Castle had not been costed.
7. That Royal was shipping pools to dealers short parts.

32. Plaintiff contends that any customer with whom Royal did business in 1972 but not in 1973 is a "lost" customer about whom defendants should have informed plaintiff. This definition strains our common sense, and we reject it. A lost customer is one who, on its own initiative, decides to buy from some other seller. The only evidence which plaintiff placed in the record on the factual issue of lost customers was a list of customers with whom Royal dealt in 1972 but not in 1973. Although Rubin testified on direct examination as to the reasons why Royal no longer dealt with some of these customers, the reasons he gave fell generally into one of two categories, either a particular customer no longer bought pools—sometimes because it was out of the pool business, sometimes because it was starting to manufacture its own pool line—or Royal, on its own initiative, chose not to deal with a 1972 customer because it had been delinquent in paying Royal. Tr. at 20:2479–89. Style, with whom Royal had done a substantial amount of business in 1972, was in this latter category. Plaintiff never placed in the record any evidence of the existence of a customer or customers who chose to cease doing business with Royal *and* go elsewhere for their supply of pools.

8. The status of pending and threatened litigation.
9. The average profit per pool.
10. The quality of the design of the Castle pool.
11. Royal's financial status.

As to numbers one through eight, we conclude that no liability exists because, as we found in Section I of this Opinion, there was no misrepresentation or failure to reveal material facts about Royal relevant to customer history, customer complaints, protected territories, supplier relationships, inventory imbalance, the costing of the Castle pool, the shipping of pools short parts, or pending or threatened litigation. As to numbers nine and ten, we will assume without so finding that defendants Rubin and Berman misrepresented the average profit per pool to be $500 and misrepresented the quality of the design of the Castle pool; as to number 11, we have already found that Royal's financial state was misrepresented through the medium of the April 30, 1973, financial statement. We find no violation of section 10(b) and Rule 10b–5, however, since we believe that any misrepresentation in these areas attributable to defendants Rubin and Berman lacked the scienter necessary for a finding of liability. The conduct of defendants Rubin and Berman was neither intended to deceive nor was it so reckless as to be virtually indistinguishable in its culpability from deliberate fraud.

B. *Liability of Defendants Rubin and Berman for Common Law Fraud*

[3] Plaintiff also claims that the same pre-acquisition conduct it alleges in making its section 10(b) charge renders defendants Rubin and Berman liable for common law fraud. In directing a verdict for the Cohen defendants on the section 10(b) claim, we also directed a verdict for them on the common law fraud claim saying:

> I believe that my conclusion that the record cannot support a jury finding of scienter under Section 10(b) disposes as well of the Common Law Fraud claim against the Cohen defendants, since the scienter requirement under Common Law Fraud is as strict as, probably stricter than, the requirement under Section 10(b).

Tr. at 18:2073. Plaintiff contends in its post-trial brief at 178–82 that this position is erroneous and that under New Jersey law, applicable here, "knowledge in a common law fraud action is even more relaxed than the Sec. 10b standard adopted by this Court." Plaintiff's brief at 178. Plaintiff has misread New Jersey law. After examining the New Jersey cases that plaintiff cites, we find that they deal not with a relaxed standard of knowledge but with a particular species of *knowing* misrepresentation. In New Jersey

> [l]egal fraud or misrepresentation consists of a material representation of a presently existing or past fact, made with knowledge of its falsity, with the intention that the other party rely thereon, and he does so rely to his damage.

Foont-Freendenfeld Corp. v. Electro Protective Corp., 126 N.J.Super. 254, 257, 314 A.2d 69, 71 (App.Div.1973), *aff'd.* 64 N.J. 197, 314 A.2d 68 (1974) (citation omitted). The particular species of knowing misrepresentation that plaintiff's cases examine is misrepresentation by a defendant that he knows a fact to exist of his own knowledge when, in fact, he has no personal knowledge one way or the other and/or is relying on someone else's opinion. Thus, in *Plimpton v. Friedberg*, 110 N.J.L. 427, 166 A. 295 (1933), defendant was held liable for common law fraud for representing to plaintiff that he knew personally that the paintings he was selling plaintiff were a Romney, a Gainsborough, and a Reynolds when, in fact, he had no such knowledge and was simply transmitting the opinion of others. The court said:

> falsity may consist in making representation of a material fact knowing it to be false, or in making a representation which is untrue without knowledge whether it is true or false *and by coupling with the representation an express or implied affirmation that it is known to be true of personal knowledge.*

110 N.J.L. at 428–29, 166 A. at 296 (emphasis added). This is not a relaxing of any knowledge requirement but merely an application of the knowledge requirement to a particular kind of deliberately fraudulent conduct. We remain convinced, therefore, that a finding that a party lacked scienter under section 10(b) disposes of any common law fraud claim against that party. Thus we find that plaintiff fails in its common

law fraud claim against defendant Rubin and defendant Berman.

C. *Liability of All Defendants for Breach of Contract*

1. *Purchase Agreement, ¶ 4.2(e): Financial Warranty*

[4] By the terms of the ¶ 4.2(e) of the Purchase Agreement, defendants warranted that both Royal's January 31, 1973, audited financial statement and its April 30, 1973, unaudited financial statement were "accurate, correct and complete and fairly present[ed] the financial position and operations of Royal as of said dates and for the periods indicated." Plaintiff asserts that defendants breached this warranty since the April 30, 1973, statement was inaccurate. Defendants concede that the April 1973 statement was inaccurate although they dispute with plaintiff the amount of the inaccuracy. We conclude, therefore, that defendants breached ¶ 4.2(e) of the Purchase Agreement and are liable to plaintiff for any damages resulting from this breach.

2. *Purchase Agreement, ¶ 4.2(q)(ii) and 4.1(d and f)*

Paragraph 4.2(q)(ii) of the Purchase Agreement warrants, among other things, that

> There are no contracts, agreements, instruments or commitments, written or oral, to which Royal is, in any manner whatsoever, subject to any prohibitions, restrictions, or directions with respect to

> (a) The . . . selling or otherwise disposing of or dealing with any products or services of any kind whatsoever. . . ., including, but without limiting the generality of the foregoing, any restriction on the right of Royal to . . . sell or otherwise dispose of or deal with any of the said products or services in the United States or Canada. . . .

Paragraph 4.1(d and f) of the Purchase Agreement warrants that none of the defendants has any legal or equitable interest in another business with which Royal has a business relationship or which is engaged in producing or selling any product produced or sold by Royal. Plaintiff contends that defendants breached the first warranty both through Royal's general practice of giving dealers so-called "protected territories" and through more formal written agreements with Style, Apex, and Regency.[33] Plaintiff contends that defendants breached the second warranty because of Berman's and Rubin's stock ownership of Regency.

[5] Before addressing the question of the breaches themselves, we point out that in this limited area of the contract breach claim, we have considered parol evidence, specifically the testimony of Berman relating his view of the nature of protected territories and his discussions with Schwefel on the subject. This testimony we credit

33. We reject the argument of the Cohen defendants made at p. 8 of their post-trial brief that the language of ¶ 4.2(q)(ii) cannot be read to cover exclusive distribution contracts.

and have included in our findings of fact. Whether we view Berman's testimony as aiding us in interpretation of the meaning of ¶ 4.2(q)(ii) or in determining the intent of the parties, we find that under New Jersey's version of the parol evidence rule, *Atlantic Northern Airlines, Inc. v. Schwimmer*, 12 N.J. 293, 96 A.2d 652 (1953), we may legitimately consider it.[34] According to Berman, then, a man experienced in the selling practices of the pool industry, Royal's practice of granting its dealers protected territories was a common one in the industry and the granting of such territories imposed no legal obligation upon Royal. Schwefel told Rubin he was familiar with the practice through his contacts with Abco, Coleco's subsidiary. Under these circumstances, we conclude that the existence of the various protected territories to which Berman testified did not breach the Purchase Agreement because the parties nei-

34. In *Schwimmer* the New Jersey Supreme Court held:

> Evidence of the circumstances is always admissible in aid of the interpretation of an integrated agreement. This is so even when the contract on its face is free from ambiguity. The polestar of construction is the intention of the parties to the contract as revealed by the language used, taken as an entirety; and, in the quest for the intention, the situation of the parties, the attendant circumstances, and the objects they were thereby striving to attain are necessarily to be regarded. The admission of evidence of extrinsic facts is not for the purpose of changing the writing, but to secure light by which to measure its actual significance.

12 N.J. at 301–02, 96 A.2d at 656.

ther intended nor understood the warranty given in ¶ 4.2(q)(ii) to cover the industry practice of granting protected territories.

As to the questions surrounding Royal's more formal agreements with Apex, Style, and Regency, we note first that we have given plaintiff the benefit of an evidentiary doubt and considered exhibits # # 383, 384, 385, 386, and 387, all correspondence between Royal and Apex in the Winter and Spring of 1973. Even considering these exhibits, however, we can locate in the record little evidence from which one could find that any agreement was in force on June 4, 1973, the critical date here. The Style agreement is dated October 1972; the Apex correspondence runs into April or May 1973. Regency never really got off the ground although Rubin testified that he believed that the contract with Gascoigne and Mitchell, the men operating Regency, was in effect past the closing date. Tr. at 27:3537. Plaintiff argues that we can reasonably assume that the Apex and Style agreements continued through June 4, 1973. The assumption is obviously more warranted in the case of Apex than in the case of Style. Given this unsatisfactory state of the record, we choose to assume without formally concluding that Royal's agreement with Apex, Style, and Regency breached the warranty contained in ¶ 4.2(q)(ii). We adopt such a procedure since, as we conclude below, the issue of whether or not any damages flowed from breach of ¶ 4.2(q)(ii) is one much more certainly and simply resolved than the issue of the breach itself.[35] We will also follow this procedure, for the

same reason, in assuming without formally concluding that Rubin's and Berman's interests in Regency violated ¶ 4.1(d and f) of the Purchase Agreement.[36]

3. *Purchase Agreement, ¶ 4.2(q)(iv and v): Inventory Warranty*

Paragraph 4.2(q)(iv and v) of the Purchase Agreement reads:

> (iv) All of Royal's finished inventory will be as of the Closing, in first class salable condition and suitable for the purpose for which it is intended.
>
> (v) All of Royal's raw materials and work in process will be in first class usable condition and suitable for the purpose for which it is intended.

35. Our conclusion on damages also allows us to sidestep the unpleasant question of whether or not, given his knowledge about the relationships between Royal and Apex, Style, and Regency, Michael Schwefel's conduct prior to acquisition, as one of Coleco's attorneys and negotiators, was of a nature requiring us to hold plaintiff equitably estopped from claiming breach.

36. Again we will sidestep the equitable issue raised by Schwefel's conduct in light of his knowledge.

37. In its proposed finding of fact # 231, plaintiff also contends, for the first time we believe, that the existence of Royal's inventory imbalance breached the inventory warranty. We reject this position since we do not believe that a standard inventory warranty such as that found in ¶ 4.2(q)(iv and v) can be stretched to cover the problem of inventory imbalance. Alternately, we find that given our finding that plaintiff knew of the inventory imbalance prior to closing, the parties did not intend the inventory warranty to cover inventory imbalance.

Plaintiff contends that defendants breached this warranty because one pool model, the Castle pool, was defectively designed.[37] Plaintiff further contends that the defective design caused several Castle pools to "blow" or pull apart in August 1973 requiring plaintiff to supply "retrofit kits" to cure the problems on some 1973 pools and on 1974 pools. Although we had serious doubts at trial, doubts that remain with us, that a standard inventory warranty, such as that contained in ¶ 4.2(q)(iv and v), is intended to cover design defect, we admitted evidence on the alleged defect after counsel stipulated that as of June 4, 1973, the closing date, there existed in Royal's inventory at least one complete Castle pool. The evidence on design defect consumed many pages of transcript and was often highly technical. Plaintiff's theory is that Rubin designed the pool with defectively thin walls and impossible welding requirements, both problems contributing to the "blowing" of Castle pools; defendants contend that the Castles pulled apart because of poor installation and shoddy welding. To conserve the judicial energy it would take to sort out any further than we already have the record evidence on this issue, we will again adopt the procedure of assuming without so concluding that defendants breached, in some highly technical way, the inventory warranty in the Purchase Agreement.[38]

38. Although plaintiff devotes pp. 127–132 of its post-trial brief to its contention that defendants breached ¶ 4.2(f)(xi) of the Purchase Agreement warranting that defendants had no knowledge of present or future loss of a substantial number of customers, plaintiff, at trial, represented explicitly that this particular warranty was out of the case. So we consider it to be. Tr. at 19:2234. Finally, at footnote 56, plaintiff's post-trial brief (pp. 126–27), plaintiff lists eleven other sections of the Purchase Agreement which it claims defendants breached. Plaintiff does not discuss these sections, however, stating "by their breach of the specific warranties. . . . , defendants also breached these more generalized warranted (sic). . . . " Since this is plaintiff's position, we remark only that while we doubt many of the sections of the Purchase Agreement cited by the plaintiff are related to the so-called specific warranties, we find nothing in these contract sections that would lead us to alter our findings and conclusions in this action.

D. *Defenses to Breach of Contract Claim*

1. *Fraudulent Inducement:*

[6] Defendant Rubin urges that we declare the Purchase Agreement void or voidable because plaintiff fraudulently induced his entering into it by making various misrepresentations, primarily by misrepresenting its intention to pay out to suppliers several hundred thousand dollars upon closing.[39] Under New Jersey law, however, a party claiming fraudulent inducement faces the difficult task of proving by clear and convincing evidence that the representations he attacks were not merely promises, collateral to the contract, to do something in the future but rather intentional misrepresentations of a present state of mind.

39. Defendant Rubin also alleges that he was fraudulently induced to enter into the Purchase Agreement by promises of production foremen, pool parts, and trucking services.

Minter v. Bendix Aviation Corp., 26 N.J.Super. 268, 274, 97 A.2d 715 (App.Div.1953); *Ocean Cape Hotel Corp. v. Masefild Corp.*, 63 N.J.Super. 369, 164 A.2d 607 (App.Div. 1960). The court in *Ocean Cape Hotel Corp.* explains the difficulty this way:

> In order to form the basis for an action in deceit, the alleged fraudulent representation must relate to some past or presently existing fact and cannot ordinarily be predicated upon matters *in futuro*. . . . An exception to this rule exists in the case of a false representation of an existing intention, *i. e.*, a "false state of mind."
>
> . . . . .
>
> If [a party's] alleged representation was a mere promise collateral to the contract, and not an affirmation of a present state of mind, then fraud may not be found because there has been no statement of an existing fact.

63 N.J.Super. at 380, 164 A.2d at 612. The court goes on to list some considerations relevant to a finding vel non of fraudulent inducement:

> Misrepresentation of a present state of mind, with respect to a future matter, may be concluded from the utter recklessness and implausibility of the statement in light of subsequent acts and events; from a showing that at the time of the making of the promise, the promisor's intention to perform was dependent upon contingencies known to the promisor and unknown to the promisee; or from

> circumstances indicating that the promisor must have known at the time of his promise that he could not or would not fulfill it. (Citations omitted).

Id. at 381, 164 A.2d at 613. Guided by the analysis of the *Ocean Cape Hotel* court, then, we conclude that defendant Rubin has not met his burden of establishing that plaintiff fraudulently induced him to enter into the Purchase Agreement. Although we have found Coleco's conduct in acquiring Royal curious and even questionable, we are not clearly and convincingly persuaded that representations Coleco made as to how it would run Royal after acquisition were anything but "promise[s] collateral to the contract." After assessing the record before us, we cannot find that plaintiff's promises were reckless or implausible or contingent upon some event known to plaintiff but unknown to defendant Rubin; nor can we locate circumstances from which to infer that Coleco must have known at the time of its promise that it could or would not perform.

2. *Equitable Estoppel:*

[7–9] The Cohen defendants contend that Coleco's knowledge, through Glassman's revelations of costing inaccuracies, of discrepancies in the financial statements estops plaintiff from claiming damages from the Cohens for breach of the financial warranty since Coleco knew the Cohens, as non-managing shareholders, were unaware of the discrepancies and failed to reveal them. In urging their position defendants

rely on *Huck v. Gabriel Realty Co.*, 136 N.J.Super. 468, 346 A.2d 628 (1975) and on a Louisiana case, *Calhoun v. American Marine Corp.*, 159 So.2d 19 (App.Div.La.). In *Huck* plaintiff was prevented from recovering on an indemnity contract because, in contracting with defendant broker for indemnity against any other broker who claimed a commission from plaintiff on a particular land transaction, plaintiff deliberately concealed from defendant broker that he had been shown the property in question by another broker prior to enlisting defendant's services. *Huck*, then, is a case involving active and intentional misrepresentation and, as such, is not particularly helpful in this case. The facts in the *Calhoun* case are admittedly much closer to the facts here. *Calhoun* is, however, a Louisiana and not a New Jersey case. More significantly, the warranty considered by the *Calhoun* court is much differently worded than the warranty here. In *Calhoun* the sellers warranted that

> Sellers know of no material facts affecting Louisiana Materials or Heartland which have not been disclosed to Purchaser.

In the case before us the financials are unqualifiedly warranted as accurate and # 13 of the Purchase Agreement states plainly:

> Coleco shall not be deemed to have waived the protection afforded it by any representation, warranty or agreement made by the Stockholders notwithstanding the fact that Coleco may have or could have known at the time of Closing that any such representation, warranty or agreement was or might be inaccurate or had been or could have been breached.

In *Calhoun* the court also relies heavily, in holding the buyer remediless, on the amount of time—a good week—during which buyer's accountant examined seller's books pre-acquisition. Here the examination was more cursory.

Furthermore, as plaintiff points out, under New Jersey case law on equitable estoppel,

> there is no obligation to disclose matters of which the other party has actual or constructive knowledge or as to which the information or means of acquiring information of the two parties is equal.

Sanders v. Reid, 131 N.Y.Eq. 407, 25 A.2d 541 (1942).[40] Certainly, under the facts of this case, the Cohen defendants, as three of the five Royal shareholders and in view of Irvin Cohen's direct ties with Royal's accountant, Zelnick, Sobelman, and Co., had as much access to the financial information in question as did plaintiff. Plaintiff also cites *Deerhurst Estates v. Meadow Homes, Inc.*, 64 N.J.Super. 134, 165 A.2d 543 (App. Div.1960), in support of its position that it is not equitably estopped from claiming breach of the financial warranty. In *Deer-*

40. In *Sanders v. Reid*, the defendant was held not equitably estopped from exercising property rights over her driveway even though she had said nothing about such rights when plaintiff built a new garage to which access could be had only by the driveway.

hurst, plaintiff discovered between the time of the execution of a land sales contract and closing of title that two of the contract warranties were breached but went ahead with closing and then sued for breach of warranty. The appellate court affirmed a verdict for plaintiff holding:

> Simply because he is informed by the defaulting party that the latter cannot or will not perform one of his obligations under the contract, the injured party, by choosing to proceed nonetheless, obviously does not manifest agreement that the performance received is in full satisfaction of all contractual obligations.

64 N.J.Super. at 145, 165 A.2d at 549. Although we agree with defendants that *Deerhurst* is significantly different from this case because in *Deerhurst* plaintiff's contractual rights had already vested when it learned of the breach, we point out that the *Deerhurst* court does have this to say on the nature of estoppel:

> Estoppel . . . is a doctrine grounded in equity, to the effect that one who performs an act or takes a position upon which it is intended that another rely cannot repudiate the act or the position where an unjust and unconscionable result would flow from such repudiations. . . . There was no repudiation on the part of Deerhurst in the case at bar. It took the position throughout that it was entitled to the benefit of all of the warranties included in the contract of sale and preserved beyond the closing date . . . . Meadow cannot claim prejudice through goodfaith reliance on any position which has subsequently been discarded.

Id. at 147, 165 A.2d at 550. In this case, as in *Deerhurst*, plaintiff has taken "the position throughout that it was entitled to the benefit of all of the warranties included in the contract of sale and preserved beyond the closing date." Moreover, accepting for the sake of argument defendants' theory that the silence at closing of plaintiff's representatives on the status of the financial warranty might have been in some way misleading, we find in the record no evidence of defendants' reliance on the implications of this silence. Defendant Irvin Cohen, the spokesman for the Cohen defendants, testified, in answering a question about the extent of his reliance in signing the financial warranty on the implied knowledgeability of plaintiff's representatives:

> Well, that really had nothing to do with my signing the agreement. That had to do with their signing the agreement.

Tr. at 31:4405. In view of New Jersey law, then, and of the distinctions between the facts of this case and those of *Calhoun v. American Marine Corp.*, we hold that plaintiff is not equitably estopped from claiming damages from the Cohen defendants for breach of the financial warranty. Considering the wording of the warranty itself, the unambiguous import of ¶ 13 of the Purchase Agreement, the equality of access of plaintiff and the Cohen defendants to Royal's books and records, and plaintiff's relinquishment of its pre-acquisition demand for a June 30, 1973, full audit in return for a

strong financial warranty, we conclude that Coleco's failure to disclose to the Cohen defendants the storm warnings it got from Glassman does not defeat its claim for breach of that warranty.[41]

E. *Damages Resulting from Breach of Contract*

1. *Damages Resulting from Discrete Breaches*:

a. Financial warranty

[10] Defendants concede that the April 30, 1973, unaudited financial statement was inaccurate in the amount of $49,922.88.[42]

41. Defendants Rubin and Berman raise a similar defense to plaintiff's claims of breach of warranty. They contend, in a two-step argument, first, that parol evidence is admissible on any breach claim to show that plaintiff had pre-acquisition knowledge of the breach, and, second, that such parol evidence clarifies the intent of the parties that the warranties were not to cover those problems of which Coleco had knowledge. Since we find damage flowing only from breach of the financial warranty, we have entertained defendants' theory only as it relates to such a breach. Having considered, then, the relevant parol evidence, we find it inadmissible on the issue of breach. Given the clear, strong language of ¶ 13 of the Purchase Agreement, the extensive detail of the Purchase Agreement, and the circumstances surrounding the acquisition, we conclude that the intent of the parties, as revealed by the Purchase Agreement itself and the circumstances of its negotiation, was to hold defendants liable for breach of the financial warranty whether or not Coleco had pre-acquisition knowledge that the warranty was or might have been breached.

42. Of this amount $17,372.88 is attributable to the failure of Royal's accountants to multiply

This amount of breach is certain, therefore. Plaintiff contends, however, that erroneous pool costing rendered the April 1973 statement inaccurate in the further amount of approximately $80,000. To prove this discrepancy, plaintiff offered in evidence the testimony of James Hubert, its controller, that he had costed the Royal pools after acquisition by examining individual parts invoices and found that mistakes in costing resulted in the $80,000 discrepancy in the April 1973 statement.[43] Hubert's testimony was bolstered by that of an expert witness, Irvin B. Schumer. Defendants attack plaintiff's damage evidence upon the following theory. As testified to by Hubert, Royal's accountants in preparing the Royal statements used an accounting technique called the FiFo (first in, first out) system under which, as testified to by Hubert, an

the material cost of a Jewel pool by the number of Jewel pools sold in February, March, and April 1973; $32,550 is attributable to the accountants' failure to reduce inventory by $350 per pool for a certain amount of finished pools sold between September 1972 and April 1973. In September 1972, when a physical inventory was taken at Royal, its accountants added $350 to reflect labor costs to Royal's inventory evaluation for each finished pool in inventory. This was the $350 per pool that should have been deducted each time one of these finished pools was sold.

43. In this area of damage testimony, Hubert testified as an expert. Although he had not been listed in the final pretrial order as an expert witness, we permitted him to testify as an expert in the interest of justice and after giving defendants overnight to depose him in his capacity as an expert.

accountant in determining costs of goods in order to relieve inventory must assume that a manufacturer, in this case Royal, used existing rather than newly-purchased inventory to make his product.[44] Tr. at 10:1163–64. On January 31, 1973,[45] Royal had between $430,000 and $469,000 of pools and parts of pools in inventory, all but $87,000 of which was purchased in the first half of 1972; the remaining $87,000 was purchased in the second half of 1972. Tr. at 10:1158–60, 12:1360–73, and 14:1501. When Royal's accountants prepared the April 1973

44. In attempting to resolve an evidentiary problem, we allowed counsel for the Cohen defendants to cross-examine Hubert outside the hearing of the jury which was, at that point in the proceedings, still sitting. At p. 8 n. 4 of its reply brief plaintiff argues we cannot consider the testimony of Hubert, during this cross-examination on Royal's use of the FiFo system since it was "offered for a limited purpose and was therefore not subjected to contradiction or verification . . . during redirect, or at any subsequent point in the trial." We disagree. First, Hubert was under oath and Coleco's own man. Second, the purpose of Hubert's testimony outside the hearing of the jury was, in the words of defendant Cohens' counsel who suggested the method, to demonstrate to us that Hubert's "testimony will prove to be incompetent even if he were an expert." Tr. at 10:1136. And, in fact, counsel moved to strike Hubert's damage testimony on the ground that it was incompetent. The trial having subsequently proceeded non-jury, we chose to regard the flaws in Hubert's damage testimony as going to the weight of plaintiff's evidence rather than as rendering the testimony incompetent.

45. February 1, 1973 was the beginning inventory date for the April 1973 statement.

statement they were dealing with the cost of the 407 pools assembled and delivered during February, March, and April 1973. Tr. at 12:1363. About 70% of the materials used to make these 407 pools was used to make the same model pools as had been made in 1972. Tr. at 10:1163. Under the FiFo accounting system, Royal's accountants would have presumed that these pools were made from the materials in inventory on January 31, 1973, that is, from materials purchased by Royal in 1972, and mostly in the first half of 1972. Tr. at 10:1163–64. Yet plaintiff's proof that the pools sold in February, March, and April 1973 were undercosted in the amount of $80,000 is based on Hubert's examination of material invoices for the period March through June 1973. Tr. at 10:1154–56 and 13:1484. About 30% of the materials used to make the 407 pools was used to make the Castle pool, a pool newly-designed in Fall 1972 and first sold and delivered in March 1973. Even in the case of the Castle pool, however, it is quite possible that a substantial amount of the materials out of which the February, March, and April Castles were made was purchased before March 1973 and May and June invoices would not be relevant at all. Based on this theory built on record evidence, defendants argue strenuously that plaintiff has failed to prove with reasonable certainty the additional $80,000 deficit because, quite simply, Hubert used the wrong invoices in checking the April 1973 statement.[46] Plaintiff's expert Schumer did no

46. Defendants first raised their challenge to Hubert's damage calculations on November 3,

more than doublecheck Hubert's calculations using the same materials Hubert had used. Tr. at 13:1484. Defendants further argue that the use of March through June 1973 invoices to prove a discrepancy in the April 1973 statement of a business using a FiFo system of accounting is particularly devastating to plaintiff's case in view of the testimony of several of plaintiff's representatives that they were aware in Spring 1973 of substantially increasing prices of aluminum, the basic material of a Royal pool. We must agree with defendants that plaintiff has not carried its burden of prov-

1975, during the course of an oral argument on plaintiff's motion for summary judgment. At that time counsel for the Cohen defendants argued that plaintiff's agent had examined the invoices for the wrong period of time and that costs of material purchased from March through June 1973 are irrelevant and not probative on the issue of the amount by which the April 1973 financial statement was inaccurate. Then, without notifying opposing counsel and without moving to amend its final pretrial order, which would lead one to believe that plaintiff was relying on the March through June 1973 invoices, as would the affidavit attached to plaintiff's motion for summary judgment, plaintiff retained an accounting firm in Philadelphia to examine 40% of the 1972 invoices. The firm apparently carried out this work over a period of three weeks and then on November 24, 1975, two weeks into the trial, plaintiff offered to prove through accounting witnesses that there was no substantial difference in the cost of parts between the 1972 and 1973 invoices. Although we recognized the blow we dealt to plaintiff's damage case, we ruled this evidence inadmissible on the ground that its use would constitute unfair surprise and would unduly prejudice defendants. We elaborate on this ruling at 11:1256–58 of the trial transcript.

ing this $80,000 item of damage by a preponderance of the evidence and with reasonable certainty. Admittedly, the record contains evidence, not offered by plaintiff, that Glassman discovered discrepancies in the costing of most of the Royal pool models. Glassman's figures were only quickly-made estimates, however, and cannot help plaintiff in establishing any particular amount of discrepancy.

[11] Plaintiff attempts to dismiss defendants' theory on the grounds that Hubert's and Schumer's testimony stands uncontradicted and that defendants "offered no evidence of the actual costs of goods sold during the period or of specific increases in particular cost items over 1972 levels." Plaintiff's post-trial brief at 119. As to the unassailability of Hubert's and Schumer's testimony, we believe it was seriously undercut on cross-examination during which defendants established that Royal used the FiFo system, that it had a very substantial amount of 1972 inventory, and that Hubert had used March through June 1973 invoices in reaching his conclusion about the inaccuracy of the April 1973 statement. Regarding defendants' failure to prove the actual cost of goods or 1973 price increases on specific items, we need only point out that the burden of proving damages with reasonable certainty was on plaintiff not on defendants. Defendants needed only to call plaintiff's method of assessing damages into serious question; this they did. We conclude, therefore, that in the absence of reasonably certain proof that there existed in addition to the $49,922.88 discrepancy in

the April 1973 statement conceded by defendants an $80,000 discrepancy, defendants are liable to plaintiff only in the amount of $44,922.88 [47] for breach of the financial warranty.[48]

b. Exclusive contracts and inventory warranties

[12] In section IIC(2 and 3) of this Opinion, we assumed without so concluding that defendants had breached ¶ 4.2(q)(ii) of the Purchase Agreement warranting that Royal was subject to no selling restrictions and ¶ 4.2(q)(iv and v), the inventory warranties.[49] We will treat together the issues of damages flowing from these particular breaches, and we find, in short, that the record is almost totally devoid of evidence upon which we could base an award

47. Under ¶ 14.4(b) of the Purchase Agreement, defendants are liable only for damages for breach of contract that exceed $5000.

48. Had we found the full $130,000 discrepancy in the April 1973 statement which plaintiff attempted to prove, this would not have affected our Findings and Conclusions below on the cause of plaintiff's $1 million loss. We do not believe that even a $130,000 discrepancy with the reduction in profitability which it implies either rendered Royal valueless or caused Royal's failure.

49. We also assumed that defendants had breached ¶ 4.1(d and f) because of their ownership of Regency pool company in Canada. Nothing in the record suggests any damages flowing from such a breach. Indeed, it appears Regency was an abortive enterprise.

of damages. As far as a breach of ¶ 4.2(q)(ii) is concerned, plaintiff offered no evidence that it lost sales because of sales restrictions assumed by Royal prior to acquisition. Although plaintiff offered some evidence that Royal was involved in post-acquisition litigation in which the opposing party claimed breach of an exclusive contract, this fact, without more, hardly proves either the existence of such a contract or any amount of breach damage. Furthermore, insofar as plaintiff claims that Royal's handling of its alleged exclusive contracts generated ill-will among its customer/dealers, we point out only that the record lacks any evidentiary support for this proposition. Nor is there any way we can determine from this record an amount of damages sustained from breach of the inventory warranties. Plaintiff offered no evidence that any of the handful of Castle pools that "blew" during the Summer of 1973 were in inventory at closing, and plaintiff seemed almost studiously to avoid placing in the record any dollar amount attributable to designing and distributing the retrofit kits. Finally, the record lacks any substantial evidence of loss of customer good will resulting from the selling of defectively designed Castle pools. Rather the record supports a finding that plaintiff made an obvious and apparently successful attempt in November 1973 to use the Royal name to attract sales for its subsidiary, Abco. We conclude, therefore, that plaintiff has failed to prove by a preponderance of the evidence any amount of damages flowing from breaches of ¶ 4.2(q)(ii) and

¶ 4.2(q)(iv and v) of the Purchase Agreement.[50]

2. *Plaintiff's Enterprise Theory of Damages*:

Under what plaintiff denominates its enterprise theory of liability, it claims damages in the amount of $878,739.65 for out-of-pocket expenses attributable to its operation of Royal post-acquisition and $135,-754.52 plus $27,000 interest, the segment of the purchase price that plaintiff paid at closing. Plaintiff contends that various breaches of the warranties in the Purchase Agreement amounted to a "total breach" of contract because they rendered Royal valueless. As a result, plaintiff urges, it should, at least,[51] be reimbursed for any monies it expended in purchasing and running Royal. We can accept the proposition that had defendants delivered to Coleco at closing a mere corporate shell lacking substantially all of the commercial attractiveness defendants had promised including new pool designs and a ready market, this type of breach could have amounted to a total failure to perform on defendants' part, in spite of their delivery of Royal's stock to Coleco, and this failure to perform might have entitled Coleco to recover the amount paid on the purchase price as well as any reasonable sums expended in reliance upon defendants' performance. See Restatement of Contracts 2nd, ¶ 268 (Tent.Draft No. 8, 1973). As we have found in Part I of our Opinion, however, this was not the case. At the very least, defendants delivered to plaintiff at closing a substantial inventory, pool designs, and customers.[52]

50. Plaintiff's counsel represented to us two weeks into trial that because of a shift in emphasis in plaintiff's case after its settlement with Zelnick, Sobleman & Co. and because of inexperience on the part of the attorneys who did the pretrial preparation, he felt it necessary to plaintiff's case to offer the testimony of additional witnesses on the issue of breaches of ¶ 4.2(q)(ii) and ¶ 4.2(q)(iv and v) and damages flowing from these breaches. Counsel therefore moved to amend plaintiff's final pretrial order by adding thirty-five additional witnesses. We denied this motion to avoid prejudice to defendants and in the interest of the orderly administration of justice. Tr. at 9:920–24.

51. Plaintiff's original damage statement included a claim for certain lost profits. We dismissed this claim at trial on the basis that an award of lost profits, on the facts of this case, would be too speculative.

52. The only evidence plaintiff offered of Royal's value on June 4, 1973, was the testimony of Coleco's treasurer Edward Fialkowsky that Royal, at closing, had no value. Tr. at 18:2155. Fialkowsky's opinion was based principally on Hubert's version of the correct April 1973 figures and on Royal's documented overhead and operating expenses. Tr. at 18:2150–51. We find Fialkowsky's testimony not to be probative for three reasons. First, Hubert's version of the April 1973 statement was never sufficiently established. Second, although the valuation of Royal with its tangible as well as intangible assets would have required expert analysis, Fialkowsky was not qualified as an expert witness. Third, as the record reveals, Fialkowsky's contacts with Royal were few and fleeting; he did not, therefore, have the intimate knowledge of Royal's workings which sometimes allows a lay witness to venture an opinion on value.

[13, 14] Rather, a more appropriate contention, under the facts of this case, is that defendants' contract breaches taken together doomed Royal's business to failure from the beginning or, to translate more fully into legally cognizable terms, defendants' contract breaches were causally and foreseeably related to Royal's failure which, in turn, caused plaintiff's losses. One preliminary difficulty with plaintiff's enterprise theory, even as we define its legal elements, is that the theory is immediately incongruous with our conclusion that plaintiff has proved only $44,922.88 in damages flowing from the different discrete breaches we have found. Even considering that the inaccuracy in the April 30, 1973, financial statement was directly and adversely related to Royal's percentage of profit on each pool model, it strains credulity to accept plaintiff's contention that discrete breaches, the reasonably ascertainable damages from which amount to less than $50,000, causally and foreseeably precipitated over $1 million in total damages. Above and beyond this incongruity, however, our factual findings require us to conclude that plaintiff has not proved by a preponderance of the evidence that defendants' breaches of contract resulted in the heavy damages plaintiff alleges. In order for us to reach the opposite conclusion, we would have to determine on the record before us that defendants' breaches, taken together, caused plaintiff's damages and that the amount and source of these damages were reasonably foreseeable at the time of contracting. *Hadley v. Baxendale*, 9 Exch. 341 (1854). We can make neither finding.

> Under New Jersey law
>
> [t]he measure of damages for a breach of warranty is . . . the loss directly and naturally resulting in the ordinary course of events from such breach. . . . The inescapable inference is that the damage complained of must stem from the breach of warranty and not from some other cause.

Prashker v. Beech Aircraft Corp., 258 F.2d 602, 607 (3d Cir.), *cert. denied*, 358 U.S. 910, 79 S.Ct. 236, 3 L.Ed.2d 230 (1958). In contending for their respective positions on the issue of causation, all parties appear to adopt a species of "but for" theory and argue about the meaning of the following testimony of Arnold Greenberg:

> Q. This morning, I think you testified, sir, that even if Rubin and Berman had innocently made a $100,000 mistake in terms of inventory, you would not have wanted to go through with the deal.
>
> A. Not for the price we are paying. Not for the million dollars.

Tr. at 3:250. In other words, the parties apparently agree that the relevant inquiry on the issue of causation is whether or not plaintiff would have gone through with the acquisition, albeit on adjusted contractual terms, if it had known about the problems created by the breaches. Although we find Arnold Greenberg's statement, by itself, too ambiguous to allow an answer to this ques-

tion, two other considerations lead us to conclude that plaintiff has failed to prove causation under a "but for" theory. First, the contract negotiations and the Purchase Agreement itself obviously contemplated the possibility that Royal might not be as profitable as everyone thought or as the April 1973 financial statement represented it to be. Presumably, the June 30, 1973, full audit, which Coleco originally demanded as a condition precedent to closing, would have revealed to plaintiff that the Royal pools were less profitable than they believed. Coleco relinquished the audit demand, however, in return for a substantial reduction from $1,000,000 to $500,000 in the non-contingent purchase price and for the contract warranties. Moreover, even the reduced non-contingent payout was arranged so that the largest single payment of $250,000 plus interest was not due until January 2, 1976. Ex. # 1 at ¶ 1.3(b). Arnold Greenberg explained Coleco's negotiating formula this way:

> We take the million dollars, divide it in half, take $500,000 and put it at the end and provide that if Royal's earnings for the years 1973, 1974 and 1975 reach a prescribed amount, then they can earn the second $500,000.
>
> The first $500,000, we would pay out in fact over a period of two years. We would pay at the closing, not $250,000, but a smaller amount, about $140,000, I think is what we proposed at that time.
>
> In other words, if we were to be persuaded to go forward without a June 30 audit, they ought to wait for their money, is what I suggested.

Tr. at 2B:58. Thus Coleco clearly entertained the possibility that Royal might not be as valuable an acquisition as hoped and, rather than calling off the deal in the absence of a full audit, built heavy warranty protections into the Purchase Agreement. Second, even if the contract negotiations and terms of the Purchase Agreement did not so mirror Coleco's willingness to contract in spite of uncertainty about Royal's value, we would still reject plaintiff's contention that had it known about discrepancies in the April 1973 statement, it would not have acquired Royal. As we have found, plaintiff, through Glassman, its costing expert and agent, was put on pre-acquisition notice that he had discovered errors in the costing of Royal pools pervasive and material enough to be of concern; despite this caveat, Coleco proceeded to closing. Even under a "but for" theory of causation, then, plaintiff's proof fails.

We are not, however, as comfortable as the parties to this action with a "but for" theory of causation. We think an alternate, and perhaps more correct way, of assessing causation in a contract breach case is to determine whether or not plaintiff has proved by a preponderance of the evidence that the event generating plaintiff's damage claim, in this case Royal's failure to operate profitably, occurred because of defendants' breaches. Addressing this question, we conclude that plaintiff has not shouldered its burden. We have already found that the more probable cause of Royal's immediate post-acquisition difficulties and eventual disintegration was not

problems arising from contract breaches but Coleco's miscalculation on the kind and amount of assistance Royal needed to enhance its chances of success. Royal was in operation only eighteen months when Coleco acquired it and had operated during 1972 at a substantial loss. The success of Coleco's investment in Royal's fledgling enterprise obviously depended on Coleco's shoring up Royal's weaknesses, especially its cash flow problems. We have found that Coleco's failure to do so was the most likely cause of Royal's failure. Thus, the event which precipitated Coleco's loss of over $1 million was not caused by defendants' actions but by plaintiff's own conduct. On the issue of causation, then, we conclude that the nature of the contract negotiations in this case, the terms of the Purchase Agreement itself, and Royal's history subsequent to acquisition demonstrate it much more likely than not that defendants' breaches did not cause the damages plaintiff claims.

[15] Although our conclusion that plaintiff has not proved causation fairly ends our inquiry, we record our agreement with defendants that plaintiff has likewise failed to establish that its loss was reasonably foreseeable. Although plaintiff discovered the problems with Royal's financial status in August 1973, it never attempted to rescind the contract and tender back the Royal stock; nor did it attempt at summer's end 1973 to place a value on Royal which had had a sizable if imbalanced inventory at closing, which purchased three quarters of a

million dollars in inventory during the Summer of 1973, and which possessed other assets such as its pool designs and a stable of customers.[53] Instead Coleco operated Royal for two years and now, tendering nothing back, demands return of the portion of the purchase price it paid as well as all monies, exceeding Royal's income, which it paid out in operating Royal for that two years. This course of conduct was surely not in the reasonable contemplation of the parties at the time of contracting.[54]

53. It is interesting to note in connection with Royal's ability to attract customers that the two lawsuits against Royal by pool dealers identified in the papers attached to the Purchase Agreement both appear to have involved dealer demands that Royal deliver more pools than it was willing or able to supply.

54. At p. 207 of its post-trial brief plaintiff lists as an item of damage $16,517 for "Costs of Defending Suits Brought against Royal." We are not sure on what this claim is based, whether on the enterprise theory or on ¶ 14.3 of the Purchase Agreement which indemnifies Coleco against fees and costs of suits occasioned by breaches of warranty. If the claim is based on the enterprise theory, it fails with our rejection of the theory. If it is based on ¶ 14.3, the claim fails because there is no record evidence that third-party litigation expenses were occasioned by Royal's breach of warranties.

F. *Defendants' Claims Against Third-Party Defendant Zelnick, Sobelman, and Company*

1. *Defendant Rubin's and the Cohen Defendants' Negligence Claim Against Zelnick, Sobelman, and Company*

Defendant Rubin and the Cohen defendants [55] contend that Zelnick, Sobelman, and Company (Zelnick), Royal's accounting firm, having negligently performed a duty owed to them, is liable to them for any amount of damages we award plaintiff for breach of the financial warranty. Zelnick responds that defendants' claim must fail because of a lack of privity between Zelnick and defendants and because the financial warranty that defendants breached imposed on them a higher duty of care than can be imposed on Zelnick. Although the state of the law in this area is uncertain, we conclude that Zelnick's argument cannot prevail and defendants' claim is a valid one.

55. At p. 1 of its post-trial brief, Zelnick, Sobelman, and Company contends that the Cohen defendants' crossclaim is insufficiently pleaded. Looking at Document # 8 in the case file, the Cohen Answer, Crossclaim, and Counterclaim, we have to agree with Zelnick that the claim against it is unsatisfactorily pleaded. Although Zelnick is listed in the crossclaim heading and relief is demanded against it, there is no statement of the basis upon which the Cohens demand relief from Zelnick. Near the end of trial, however, counsel for the Cohens moved that if the pleadings were deficient, they be conformed with the proof. We consider this a motion pursuant to Fed.R.Civ.P. 15(b), and we grant the motion.

We also point out here that only defendant Rubin and the Cohen defendants claim against Zelnick; defendant Berman does not.

[16] The more difficult question raised by defendants' claim is whether or not parties not in strict privity with an accountant can invoke a duty of care running from the accountant to them. The contract, in this case, was between Zelnick and Royal not between Zelnick and the individual defendants; thus there is no strict privity between Rubin and the Cohens and Zelnick. Although we can find no New Jersey cases and only one vintage Pennsylvania case treating the issue under consideration, we note that modern courts often begin their analysis of a privity requirement with an examination of Justice Cardozo's opinions in *Glanzer v. Shepard*, 233 N.Y. 236, 135 N.E. 275 (1922) and *Ultramares Corp. v. Touche*, 255 N.Y. 170, 174 N.E. 441 (1931). *See, e. g., Rusch Factors, Inc. v. Levin*, 284 F.Supp. 85 (D.R.I.1968) and *Aluma Kraft Manufacturing Co. v. Elmer Fox & Co.*, 493 S.W.2d 378 (Mo.App.1973). In *Glanzer*, Cardozo held public weighers liable to a buyer of bags of beans for breach of a duty to weigh the beans carefully. In reversing the New York appellate court, which had found for defendant on the ground that plaintiff had no contract with the weighers, Cardozo said

> We think the law imposes a duty toward buyer as well as seller in the situation here disclosed. The plaintiffs' use of the certificates was not an indirect or collateral consequence of the action of the weighers. It was a consequence which, to the weighers' knowledge, was the end and aim of the transaction. . .

> assumption of the task of weighing was the assumption of a duty to weigh carefully for the benefit of all whose conduct was to be governed. We do not need to state the duty in terms of contract or of privity. Growing out of a contract, it has none the less an origin not exclusively contractual. Given the contract and the relation, the duty is imposed by law.

233 N.Y. at 238–39, 135 N.E. at 275. In *Ultramares*, Cardozo refused to hold accountants liable to plaintiff corporation which had loaned money to another corporation relying in part on an inaccurate balance sheet certified by the accountants. In reciting the facts, however, Cardozo emphasized that

> Nothing was said as to the persons to whom these counterparts would be shown or the extent or number of the transactions in which they would be used. In particular there was no mention of the plaintiff, a corporation doing business chiefly as a factor, which till then had never made advances to the Stern Company, though it had sold merchandise in small amounts.

255 N.Y. at 174, 174 N.E. at 442. He also distinguished *Ultramares* from *Glanzer* on the basis that in *Glanzer*:

> the transmission of the certificate to another was not merely one possibility among many, but the "end and aim of the transaction," as certain and immediate and deliberately willed as if a husband were to order a gown to be delivered to his wife . . . . The bond was so close as to approach that of privity, if not

> completely one with it. Not so in the case at hand. No one would be likely to urge that there was a contractual relation, or even one approaching it, at the root of any duty that was owing from the defendants now before us to the indeterminate class of persons who, presently or in the future, might deal with the Stern Company in reliance on the audit. In a word, the service rendered by the defendant in *Glanzer v. Shepard* was primarily for the information of a third person, in effect, if not in name, a party to the contract, and only incidentally for that of the formal promisee.

Id. at 182–83, 174 N.E. at 445.

We agree with the courts in *Rusch Factors* and *Aluma Kraft* that *Glanzer* and *Ultramares* are, as Justice Cardozo stated, distinguishable and we find the facts of the present case to be closer to those of *Glanzer* in spite of their superficial resemblance to those of *Ultramares*. Here the bond between defendants and Zelnick "was so close as to approach that privity, if not completely one with it." Moreover, defendants use of the April 1973 statement "was not merely one possibility among many, but the 'end and aim of the transaction'." Finally, defendants in this case were not members of an "indeterminate class of persons who, presently or in the future, might deal . . . in reliance on the audit."[56] We also agree

56. *Landell v. Lybrand*, 264 Pa. 406, 107 A. 783 (1919), the one Pennsylvania case treating the problem under consideration here, resembles *Ultramares*. In *Landell* the Pennsylvania Su-

with the *Rusch Factor* court that regardless of whether *Glanzer* and *Ultramares* are distinguishable, the view more consonant with present notions of equitable loss distribution is that which holds accountants

> liable in negligence for careless financial misrepresentations relied upon by actually foreseen and limited classes of persons.

284 F.Supp. at 93. We conclude, therefore, that defendants' lack of strict privity does not preclude their claim against Zelnick when Zelnick knew of the purpose of the April 1973 audit and the use to which it would be put.[57]

[17, 18] Zelnick further contends, however, that whether or not lack of privity

preme Court denied relief against accountants to a plaintiff who had invested on the basis of a prospectus prepared by the accountants containing false information. In finding for defendant accountants the court said:

> The averment in the statement of claim is that the defendants were careless and negligent in making their report; but the plaintiff was a stranger to them and to it, and, as no duty rested upon them to him, they cannot be guilty of any negligence of which he can complain.

Landell is thus distinguishable from the present case in that the Royal shareholders were hardly "strangers" to Zelnick.

57. Although there is no direct testimonial evidence on point, we infer from Zelnick's close relationship with Royal and from the fact that the Zelnick accountants worked directly with Hubert during the immediate pre-acquisition period to prepare the April 1973 statement for closing, that Zelnick was aware of the purpose of preparing the statement.

bars defendants' recovery against it, the claim must fail because the warranty defendants made imposed a strict liability on them while Zelnick's alleged liability to defendants can only be based on concepts of negligence. We believe Zelnick misconceives its duty here and the consequences of a breach of that duty. In reliance[58] on Zelnick's work in preparing the April 1973 statement, defendants warranted that statement; Zelnick knew of defendants' reliance. Now that we have found defendants liable in damages to plaintiff for breach of the financial warranty, a breach resulting from mistakes in the April 1973 statement admittedly made by Zelnick, the logical and legal conclusion is that Zelnick's negligence was the proximate and foreseeable cause of defendants' injury.[59] The court in *Ryan v. Kanne*, 170 N.W.2d 395, 401 (Iowa 1969), puts the proposition this way:

58. At p. 11 of its post-trial brief Zelnick argues that the failure of Lewis and Frederick Cohen to testify personally that they relied on the work of Zelnick in making the financial warranty precludes them from establishing reliance. We agree with defendants, however, that *Judson v. Peoples Bank & Trust Co.*, 25 N.J. 17, 134 A.2d 761 (1957), a case factually similar to this one, disposes of Zelnick's argument.

59. If the errors Zelnick made in the April 1973 statement were less obvious and mechanical than they were, we might have had to determine the scope of Zelnick's undertaking in compiling the statement. We avoid the determination here because we believe even the most restricted undertaking would impose on Zelnick a duty to multiply correctly and to make overhead deductions from inventory that can be simply computed.

> When the accountant is aware that the balance sheet to be prepared is to be used by a certain party or parties who will rely thereon in extending credit or *in assuming liability for obligations of the party audited*, the lack of privity should be no valid defense to a claim for damages due to the accountant's negligence. We know of no good reason why accountants should not accept the legal responsibility to known third parties who reasonably rely upon financial statements prepared and submitted by them.

(emphasis added). We agree.[60, 61]

60. Zelnick has insisted throughout this litigation that the unaudited status of the April 1973 statement should somehow relieve it from liability for its admitted failure to multiply and to deduct overhead from inventory. We cannot agree. Rather we align ourselves with the position of the court in *Ryan v. Kanne*, 170 N.W.2d 395, 404 (Iowa 1969), that

> Although in [the accounting] profession a distinction is made between certified audits where greater time and effort are expended to verify book items, and uncertified audits where greater reliance is placed on book items, it is clear to us that accountants, or any other professional persons, must perform those acts that they have agreed to do under the contract and which they claim have been done in order to make the determination set forth and presented in their report. Their liability must be dependent upon their undertaking, not their rejection of dependability. They cannot escape liability for negligence by a general statement that they disclaim its reliability.

The errors here were not subtle ones. Avoidance of them required neither a costing check nor an inventory. Under these circumstances, we make no distinction between an audited and an unaudited statement.

2. *Claim of All Defendants for a Set-Off Against Their Liability of the Amount Paid in Settlement to Coleco by Zelnick*:

[19, 20] Plaintiff concedes that the damages sought under its contract claim and those sought under its 10b–5 claim are the same. On the basis of this concession, defendants urge that we apply New Jersey's one-satisfaction rule, *Breen v. Peck*, 28 N.J. 351, 146 A.2d 665 (1958), which holds simply that if a party's claim has been fully satisfied, he has no further claim. Under the rule, if applicable, any settlement amount is set-off against the liability of the remaining defendants.[62] Defendants do admit that

61. Although we have not analyzed the issue of Zelnick's liability to defendant Rubin and the Cohen defendants strictly in terms of a right vel non to indemnity, we would reach the same result if we undertook such an analysis. We would hold Zelnick primarily liable for the inaccuracies in the April 1973 statement and defendants only secondarily liable, such a relationship giving rise to a right of defendants to indemnity.

62. Plaintiff claims at n. 20(a) of its reply brief that defendants should not be allowed to avail themselves of the one-satisfaction rule since they failed to prove on the record the consideration for the Zelnick settlement. This is not accurate. There was the following exchange between David Berger and counsel for the Cohen defendants on cross-examination:

> Q. Now, there came a time in this matter, sir, when a settlement was made with one of the defendants; did there not?
> A. Yes.
> Q. That was with Zelnick, Sobelman and Company; is that correct?

there are two difficulties with applying the one-satisfaction rule in this case, first, because the settled claim was brought under Rule 10b–5 and the successful unsettled claim was brought in contract and, second, because a line of New Jersey case law collateral to the *Breen* line of cases holds that the one-satisfaction rule does not always apply. See, e. g., *Theobald v. Angelos*, 44 N.J. 228, 208 A.2d 129 (1965). We agree with defendants, however, that these difficulties should not preclude a set-off in this case. The New Jersey cases appear to focus on the identity of damages resulting from different claims, not on the identity of the legal theories supporting the claims. In fact the court in *Breen* applied the one-satisfaction rule when one claim was based on contract and one on tort. Furthermore, the reasons *Theobald* gives for not applying the one-satisfaction rule in that case do not apply here. The quantum of damages which amounts to full satisfaction is not difficult to assess here, and defendants are not "wrongdoers" in the sense that a negligent tortfeasor is a wrongdoer. We conclude, therefore, that New Jersey's one-satisfaction rule should apply in this case. Since the settlement between plaintiff and Zelnick was for $350,000, a set-off of the settlement amount against the amount of damages defendants owe plaintiff reduces the amount owed to zero.

A. Yes.
Q. And the settlement amount, as I recall, was $350,000; was it not?
A. Yes.
Tr. at 25:3179.

G. *Defendants' Counterclaim against Plaintiff for the Balance of the Purchase Price and for Repayment of Loans*

[21] From the time plaintiff filed suit in December 1973, it has paid nothing to defendants under the terms of the Purchase Agreement. This means that of the total purchase price of $500,000, $350,000, plus 6% interest from May 1, 1973, and personal loans amounting to $43,334 remain unpaid. All defendants counterclaim against Coleco for these sums. Plaintiff denies their claim arguing, first, that under ¶ 8.1 of the Purchase Agreement proof of any warranty breach totally excuses all unpaid consideration including purchase price and loans and, second, that the serious nature of the breaches in this case excuses plaintiff from any future performance.

Section 8 of the Purchase Agreement begins:

> The obligations of Coleco under this Agreement shall at all times be subject to the following conditions precedent, any of which may be waived by Coleco:
>
> 8.1. *Accuracy of Representations and Warranties.* The representations and warranties of the Stockholders herein contained shall be true on and as of the Closing Date except as affected by transactions contemplated hereby and except to the extent that such representations and warranties were made as of a specified date and as to such representations and warranties, the same shall have been true as of the specified date.

Focusing exclusively on this language, plaintiff urges that we read it to preclude defendants' counterclaim. We cannot accept plaintiff's position for two reasons. First, under plaintiff's reading of ¶ 8.1, the most trivial breach could trigger the forfeiture of up to $365,000 of the purchase price. Indeed in this case plaintiff asks us to excuse the payment of that amount after having proved less than $50,000 in breach damage. Should we attribute such effect to ¶ 8.1, we would feel constrained to void it as a penalty. Second, and more significantly, when ¶ 8.1 is considered together with the rest of section 8 and other provisions of the Purchase Agreement, it becomes clear that non-breach of warranty was a condition precedent to Coleco's obligation to come to closing not to its obligation to pay the purchase price after closing.[63] The whole of section 8, entitled *Conditions Precedent to Obligations of Coleco*, contains ten subsections the particular contents of most of which make it obvious that the duties imposed are conditions precedent to closing. In isolation the import of ¶ 8.1 is perhaps not so obvious, but, when read with the rest of the list, it falls naturally into the pattern. The pattern continues into ¶ 9 of

63. Plaintiff contends that one cannot make this distinction because "in this instance the execution of the purchase agreement, including Paragraph 8, occurred June 4, 1973, *simultaneously* with the closing." Plaintiff's reply brief at 28. We don't agree. The Purchase Agreement is dated May 1, 1973, and whether or not actually executed until June 4th, it obviously contemplates a hiatus between the drafting and dating of the contract and the closing date.

the Purchase Agreement, entitled *Conditions Precedent to Stockholders Obligations* and undoubtedly a companion provision to section 8, which imposes on Coleco an obligation obviously keyed to closing to have delivered to each Royal shareholder:

> a favorable opinion of Arnold C. Greenberg, Esq., Counsel for Coleco, dated the Closing Date and covering the matters contained in all of the Subsections of Section 5.

The first sentence of ¶ 3.1 also reinforces our interpretation of ¶ 8.1. The sentence reads:

> Unless this Agreement is terminated as herein provided, the consummation of the sale, transfer, and delivery of the Royal Shares shall take place at 2650 Haddonfield Road, Pennsauken, New Jersey, on June 4, 1973 at ten o'clock in the forenoon.

Although ¶ 3.1 does not refer directly to sections 8 and 9, they are the logical referents. Finally, interpreting ¶ 8.1 as plaintiff suggests renders meaningless ¶ 1.5 which reads:

> Coleco shall have the right to deduct from the purchase price provided for in Subsections 1.3 and 1.4 *as the same shall become due* the amount of any damages to which Coleco is entitled as a result of any breach of any of the Stockholders representations, warrants, covenants, or agreements as set forth herein.

(emphasis added). Plaintiff would simply have no need for ¶ 1.5 if ¶ 8.1 means what plaintiff says it does. We resist reading

one provision of a contract so that it renders another provision superfluous, especially when an interpretation reconciling the two so clearly presents itself. In sum, then, we reject plaintiff's interpretation of ¶ 8.1 as automatically excusing it, once breach is proven, from any future performance under the Purchase Agreement.

[22] In the alternative plaintiff contends that should its future performance not be excused by the terms of the Purchase Agreement, it is excused because of the materiality of the breaches proved. We must also reject this contention since, applying the tests of materiality laid down in § 275 of the Restatement of Contracts (see also Restatement (Second) of Contracts § 266 (Tent. Draft No. 8, 1973)), we conclude that the breaches we have found are not significant enough to excuse plaintiff's future performance. Section 275 of the Restatement lists the following factors for consideration in determining the materiality of a breach:

(a) The extent to which the injured party will obtain the substantial benefit which he could have reasonably anticipated;

(b) The extent to which the injured party may be adequately compensated in damages for lack of complete performance;

(c) The extent to which the party failing to perform has already partly performed or made preparations for performance;

(d) The greater or less hardship on the party failing to perform in terminating the contract;

(e) The wilful, negligent or innocent behavior of the party failing to perform;

(f) The greater or less uncertainty that the party failing to perform will perform the remainder of the contract.

Given plaintiff's pre-acquisition knowledge, through Glassman and Schwefel, of both the Royal strengths and the Royal weaknesses, the limited amount of breach damage proved in proportion to the amount of the purchase price plaintiff wishes to avoid, defendants' performance in delivering Royal, and defendants good faith dealing, we conclude, influenced most heavily by factors (a) through (e) of § 275, that defendants' breaches are not so material either singly or in combination as to excuse plaintiff's performance. Plaintiff is therefore liable to defendants, on the Purchase Agreement, for the balance of the purchase price and for the unpaid loans.

H. *Claims of Breach of Defendant Berman's and Defendant Rubin's Employment Contracts*

One of the conditions under which plaintiff purchased Royal was that Berman and Rubin execute three-year employment contracts with Royal and continue to run it. Coleco's reasons for making such a condition were admittedly to acquire Berman's and Rubin's talents, highly rated by Coleco

management, and inferentially to neutralize two effective competitors.[64] The employment contracts, appended to the Purchase Agreement and executed at the same time as the Purchase Agreement, obviously contemplated that Berman and Rubin would serve in highly responsible executive and managerial positions with Royal. This intention is reflected in the description of Berman's and Rubin's duties in ¶ 2 of the employment contract:

> Your duties in the first instance shall be substantially similar to those performed by you for ROYAL during 1972 and 1973. Such duties shall include active responsibility for ROYAL's sales force and marketing organization, for ROYAL's manufacturing operations and for directing ROYAL's product development activity. Your duties may also include from time to time such other reasonable executive responsibilities as relate to ROYAL as may be assigned to you by the Board of Directors of ROYAL or by the President, Senior Vice President or Executive Vice President of COLECO INDUSTRIES, INC.

64. The employment contracts themselves both contain the following provision:

> For a period of two years after expiration or termination for any reason whatsoever of your employment by ROYAL, you will not directly or indirectly own, manage, operate, join, control or participate in the ownership, management, operation or control of, or be an employee or an independent contractor with respect to, or be connected in any manner with, any business, whether owned by an individual, corporation, partnership or any other entity, which (a) manufactures or sells anywhere in the United States of America products reasonably similar to those manufactured or sold by ROYAL or * at the time of such expiration or termination of said employment; or (b) renders services or engages in activities anywhere in the United States of America substantially similar to those rendered and engaged in by ROYAL at the time of such expiration or termination of said employment. . . .

¶ 8. And, in fact, in the letter of termination to Berman (Ex. 146), plaintiff reminds him of this provision.

In return for competent performance of duties, Rubin and Berman were to receive set salaries plus a bonus on each "deluxe pool" sold, with "deluxe pool" defined as "any pool ROYAL sells for $1000 or more." Both sides now claim breach of the employment contracts.

[23] Although the standard in New Jersey by which one judges a claim of breach of an employment contract is easily stated, we find it not easily applied to the facts of this case. All parties agree that

> Misconduct prejudicial to a master's interest is good cause for discharge, but the misconduct must be gross, e. g., insubordination, exerting a bad influence over other servants, producing injury to the employer's business.

Sawyer v. E. F. Drew and Co., 111 F.Supp. 1, 2 (D.N.J.1953). In applying this standard to defendant Berman and to his acquittal of his duties during the Summer of 1973, we conclude, reluctantly, that he did breach his employment contract and that plaintiff had legal cause to discharge him. We wish to make clear, however, both the facts upon

which we base this conclusion and those upon which we do not base it. Berman was a salesman, a good one; he was not a production man. We do not believe his refusal to help Rubin in the factory or his initial reluctance to work on the inventory constituted a dereliction of duty. Nor can we find that he was not spending sufficient time on sales and in attempting to collect receivables. In the first place, Royal's problem was a glut of sales orders coupled with a dearth of pools to fill these orders; in the second place, the older receivables were highly difficult to collect because Royal was not delivering on its newer orders. There is a combination of facts, however, that persuades us that Berman did not fulfill his contract. Although Berman had no duty to engage in what would have been essentially a waste of his time trying to help out in the factory, he did have a duty to help Rubin where he could with the office work so that Rubin would be freer to deal with those aspects of the business that only he could handle. We have credited Rubin's testimony that Berman was remiss in this area and, particularly, that "Berman never Credited dealers on returns. He never Debited suppliers on returns. Generally the office work was a disaster." Ex. R–35 at 4. In addition, Berman's having told Rubin that "he will do what he wants and let Coleco fire him then he will sue," bespeaks an attitude, albeit one born out of frustration and developed under severe working pressure, that would obviously not redound to his employer's benefit. For whatever reason, Berman also prepared an

unrealistic, and therefore unacceptable, 1974 sales projection for presentation at a July meeting in Hartford, a significant failure for an employee in Berman's position. Finally, Berman simply left Royal for a few weeks in August, one of the three or four crucial months in the pool selling industry. During the time he was gone he missed an important executive meeting in Hartford. Although we credit Berman's testimony that his August leave was precipitated by his distress over the restrictions Coleco was imposing on him and over intense business pressures in general, we believe that Berman's unilateral decision, without notifying Coleco, to abandon his duties at Royal at the time and for the duration he did was a serious dereliction of duty.[65] Although we sympathize with Mr. Berman's situation during the Summer of 1973, we conclude that having accepted from Coleco the executive and managerial position which he did, he had an obligation to Coleco to withstand the pressures of the business turmoil in which he found himself. In sum, while the burden on an employer to prove breach of an employment contract is a substantial one under New Jersey law, we hold that on the facts as we have found them, plaintiff has

65. Possibly medical evidence documenting Berman's psychological and physical condition in July and August 1973 would have been relevant on the issue of his breach of his employment contract. Although Berman's counsel had some thought of offering such evidence, we precluded him from doing so for failure fairly to comply with discovery requests. Tr. at 1:25–27.

carried its burden and defendant Berman's claim must fail.[66]

[24–28] In moving to defendant Rubin's claim, we note preliminarily that his performance during the Summer of 1973, in contrast to Berman's, was well above and beyond the call of duty. He worked long days seven days a week most of the Summer, without the help he had been promised and able to deal directly only with Schwefel and Hubert. The difficulty with Rubin's claim, then, is not with his quality of performance but with the fact that he was not discharged; he resigned. At no time did Coleco either cut off his salary or threaten to do so, and, in fact, top members of the Coleco management told him they wanted him to stay on at Royal. After considering

66. Our conclusion that Berman breached his employment agreement does not affect our earlier conclusions that defendants did not totally breach the Purchase Agreement and that their contract breaches did not cause plaintiff to suffer over a million dollars in damages. First, we note that the Purchase Agreement itself specified the damages which were to flow from a breach of one of the employment contracts. Paragraph 1.4(d)(ii) reads in part:

> In the event that either Berman or Rubin voluntarily terminate his employment with Royal, or his employment is terminated for legal cause, forty percent . . . of any sums due the Stockholders pursuant to Subsection 1.4(d)(i) (providing for payment of the contingent purchase price) shall be forfeited and not paid for any period that either employee . . . has not been continuously employed by Royal.

Second, Berman's breach of his employment contract, even in combination with any other breaches we have found, did not render Royal valueless and did not cause its failure.

Rubin's situation in November 1973, however, we conclude that there are other ways to breach an employee's contract besides actually discharging him without cause and that plaintiff is indeed liable to Rubin for breach of his employment contract. Although the facts in *Atlantic City v. Farmers Supply and Products Co.*, 96 N.J.L. 504, 508, 115 A. 388 (1921), are distinguishable from the ones presented here,[67] we believe applicable to this case the following principle of law laid down by the *Atlantic City* court:

> Where a contract obliges one party to perform it, and its performance, within the intention of the parties, requires the performance of a correlative obligation by the other party, such obligation will be implied.

Here we conclude that Coleco had an obligation to cooperate with Rubin so that he could perform his contractual duty to manage Royal. Given Rubin's high competence in designing and producing pools, the talent for which he was hired, Coleco had an obligation to allow him to exercise that competence to insure the success of a business in which he had both a psychological and financial stake. Instead, Coleco denied his requests for personnel and cash for suppliers, refused to communicate with him, issued orders to his subordinates at Royal without consulting him, and made decisions

67. One immediate factual distinction is that the contract in *Atlantic City* was not an employment contract but a contract between Atlantic City and an independent contractor.

affecting Royal, such as the use of the Royal name by Abco, without consulting him. Discharge is not an employer's only way of separating itself from an employee. Finally, we conclude that Coleco's avowed intention of moving most of Royal's production to Connecticut breached ¶ 3 of its employment agreement with Rubin which reads in part:

> In the event that it is determined during the term of this Agreement to relocate ROYAL's business, the parties agree that said relocation will be within a radius of thirty (30) miles from ROYAL's present location.

It appears that rather than Rubin's leaving Royal, Royal, in most material respects, left Rubin. We hold, therefore, that Coleco breached Rubin's employment contract and is liable to Rubin for $70,506.80 representing the salary due him under the contract.[68] We further hold, however, that Rubin has not carried his burden of proving with reasonable certainty that plaintiff is liable to him in the amount of $7,440 representing the bonus on 1488 pools sold in 1973 and 1974. Rubin's evidence consists solely of his testimony that to his knowledge Royal sold no pools in 1973 for under $1000 and that he had seen Abco's 1974 price list for Royal pools on which no pool was listed for under $1000. Tr. at 24:3132–33 and 24:3133–34. He also testified, however, that Royal gave volume discounts, that Berman handled these discounts, and that he could have

68. This figure includes a deduction for employment earnings from other sources during the contract period. Ex. 379A.

been unaware of the discounts given. Tr. at 24:3139. Finally, he testified that he was unaware of Abco's discounting practices in 1974. Based on this evidence, we conclude that Rubin has not carried his burden of demonstrating with reasonable certainty any particular amount of damage. Although he has established the fact of damage and this may allow us to lower the standard of reasonable certainty, to some degree, in assessing an amount of damage, we find that the evidence permits us only to speculate as to the number of pools out of the 1488 pools sold for under $1000. We know neither how frequently Berman or Abco gave volume discounts nor how frequently this practice might have reduced the cost of an individual pool to less than $1000. It does not appear improbable, for instance, that Castle pools, priced as they were at the lower end of the Royal line, might have been discounted to less than $1000 a pool.

I. *Uncollected Accounts Receivable*

[29] Coleco's employees testified that as of the time of trial, $30,000 of Royal's accounts receivable were yet uncollected. Although this amount does not qualify as damages for breach, plaintiff claims it still is due it under ¶ 6 of the Purchase Agreement which provides in part:

> The Stockholders shall cause Royal to take all reasonable steps to collect the accounts receivable of Royal as at April 30, 1973. If twelve (12) months after the Closing Date any of the accounts receivable of Royal as at April 30, 1973 are then

> unpaid, Coleco shall have the right to claim a reduction in the Purchase Price equal to the amount of such unpaid accounts receivable which exceed the reserve set forth in the balance sheet as at April 30, 1973.

The reserve was $5000. Defendants urge that we reject this claim for plaintiff's failure to comply with the procedure reasonably contemplated by ¶ 6. Cohen defendants' post-trial brief at 12–13. We will heed defendants' urgings. Paragraph 6.1 provides for a reduction in the purchase price to cover uncollected accounts receivable. Such a remedy would now be impossible if all contract terms had been complied with since the purchase price would be completely paid. Paragraph 6.2 provides:

> In the event that Coleco shall claim a reduction in the Purchase Price as provided in Article 6.1, upon payment of such amount to Coleco, Coleco shall cause Royal to assign the account or accounts receivable to the Stockholders.

We conclude that a fair reading of ¶ 6 is that Coleco had an obligation to initiate reassignment of the accounts receivable under ¶ 6.2 within a reasonable time after June 4, 1974. Waiting to claim them under this judgment has placed defendants in the virtually impossible position of attempting to collect accounts more than three years old. We deny the claim.

J. *Attorneys' Fees and Costs*

[30, 31] Under ¶ 14 of the Purchase Agreement entitled *Indemnification of Stockholders* defendants agreed to "indemnify and hold Coleco harmless against":

> 14.2 All damages or deficiencies resulting from the inaccuracy or breach of any representation, warranty or agreement set forth in this Agreement or in any schedule, certificate, list or other instrument delivered by Stockholders, whether made as of the date hereof or as of the Closing Date or otherwise.
>
> 14.3 All actions, suits, judgments, costs and expenses incident to any of the foregoing, including legal fees and reasonable costs of investigation.

Under this provision plaintiff claims $410,550.27 in legal fees and costs billed to it up to March 13, 1976. Included in this amount are approximately $64,387 in costs, $250,153.29 in fees to David Berger, P.A. (David Berger), for 3445 attorney hours worked, $34,237.50 in fees to David Berger for 1369 and ½ non-attorney [69] hours worked, and $61,772.96 in fees to David Berger for 850 and ¾ hours worked by the Washington, D. C., firm of Yablonski, Both, and Edelman hired by David Berger to participate in the post-trial briefing. Affidavit of James Hubert, Doc. # 291, as modified and further detailed by Affidavit of David Berger, Doc. # 293, ¶¶ 5 and 37. Although we are influenced in our approach to the issue of attorneys' fees by principles laid down by the Court of Appeals for the Third Circuit in the *Lindy* cases, *Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary*

69. Non-attorneys include law clerks and paralegals.

Corp., 487 F.2d 161 (3d Cir. 1973), and *Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary Corp.*, 540 F.2d 102 (3d Cir. 1976), we believe these cases, involving the judicial award of attorneys' fees, only indirectly applicable to this case involving the recovery of attorneys' fees and costs as an item of damage under a contract. Directly applicable is *Cohen v. Fair Lawn Dairies*, 86 N.J.Super. 206, 206 A.2d 585, *aff'd*, 44 N.J. 450, 210 A.2d 73 (1965), in which a New Jersey appellate court enforced an attorneys' fees provision in a contract holding that it does not violate New Jersey public policy for

> a party to a written agreement [to] bind himself, by express stipulation therein, to liability to the other for the reasonable legal expense of maintaining an action for breach of the agreement as part of the recoverable damages in the event of such breach.

86 N.J.Super. at 208, 206 A.2d at 586. The court further held such a recovery of attorneys' fees was simply another item of damages to be proved as any other item of damages. *Id.* at 216, 206 A.2d 585. Finally, in addition to requiring that any attorneys' fees recovered under contract be reasonable and necessary, the court went on to recommend to the trial court on remand the following qualifications on recovery of contractual attorneys' fees noted by the Court of Appeals for the District of Columbia Circuit in *Manchester Gardens v. Great West Life Assurance Co.*, 92 U.S.App.D.C. 320, 205 F.2d 872 (1953):

> "Similarly, where the merit or necessity of the creditor's claim or defense is successfully challenged, courts may decline to enforce attorney's fee provisions. When contractual provisions for payment by a debtor of his creditor's attorney's fees and costs are invoked, such payment should not be enforced in the full amount of the creditor's legal expenses (even though actually incurred, and reasonable in amount) where his claims or defenses giving rise to such expenses lack substantial merit. In no event should the sum allowed be so large as to amount to an undue penalty for taking one's grievance to the courts."

86 N.J.Super. 216–17, 206 A.2d 590, *quoting*, 205 F.2d at 878.

In approaching, under the guidance of *Cohen*, what has been a particularly difficult problem for us, we begin with defendants' contention that ¶ 14 of the Purchase Agreement provides for attorneys' fees only in actions involving plaintiff and third parties and that it does not expressly enough provide for attorneys' fees in an action between the parties to the Purchase Agreement. We cannot accept this contention. While *Cohen* requires an "express stipulation" and while the contractual provision in *Cohen* is more detailed than the one under consideration here, we conclude that the express terms of ¶ 14.2 and 14.3 read together provide for attorneys' fees in this action. Paragraph 14.2 indemnifies Coleco against "*[a]ll* damages . . . resulting from the inaccuracy or breach of any repre-

sentation, warranty or agreement set forth in this Agreement"; paragraph 14.3 explicitly includes in the items against which defendants indemnify plaintiff "*[a]ll* . . . suits . . . *incident to any* of the foregoing, including legal fees and reasonable costs of investigation (emphasis added)." Although this language is broader and more general than that of the contractual provision in *Cohen,* we consider it no less express. It is quite similar to the provision enforced in *Manchester Gardens* which required the mortgagor to pay:

> "All costs and expenses and attorney's fees . . . of the Trustee and of the Beneficiary [mortgagee] in case of *any* litigation *involving* this property."

205 F.2d at 876 (emphasis added).

Next we confront the question of whether or not plaintiff has proved, as an item of damages, a *reasonable* attorneys' fee.[70] We

70. In approaching the concept of reasonableness, we note that in *Cohen* the attorneys' fees provision itself used the word "reasonable" to modify the term "counsel fees." In the present case the term "legal fees" is unmodified although the term "costs of investigation" is modified by "reasonable." In view of what we perceive to be the clear message of the *Cohen* court, however, we reject any inference that this discrepancy would allow us to award *unreasonable* attorneys' fees, even under contract. First, the *Cohen* court's initial identification of the general issue in the case, made before it considered the particular contractual provision in question, couches the problem in terms of whether or not "reasonable legal expense" may be provided for contractually. 86 N.J.Super. at 208, 206 A.2d 585. Second, although the court discusses the issue throughout the opinion in terms of "reasonable" fees, it never links the requirement of reasonableness to the use of the word "reasonable" in the contract provision. Finally, the broader policy justifications for limiting contractual attorneys' fees invoked at the end of the *Cohen* opinion apply in some instances even to fees "actually incurred, and reasonable in amount." 86 N.J. Super. 116–17, 206 A.2d 590. They must obviously, then, apply to unreasonable fees.

note here that we have considered the concept of reasonableness from two vantage points in reaching our determination on attorneys' fees. We considered, first, the reasonableness of the amount claimed focusing narrowly on the hourly rates charged plaintiff and the number of hours claimed. Then we considered the reasonableness of the amount claimed focusing broadly on notions of public policy and fairness. Record evidence on the issue of attorneys' fees consists of trial testimony by David Berger (Tr. at 25:3170–3235) and affidavits submitted by David Berger, James Hubert, and Theodore Mann, attorney for the Cohen defendants. Although we reopened the trial record for a hearing on the issue of attorneys' fees on June 11, 1976, counsel after brief argument elected to stand on the evidence already presented.[71] The

71. Although the *Cohen* court instructed the trial court that on remand, more would be required to prove reasonable attorneys' fees than ex parte affidavits, the New Jersey Supreme Court in affirming the appellate court did modify this requirement holding that, in the absence of objection by opposing counsel to proof by affidavit,

> there would generally be no reason for requiring plenary proof, provided the record before the trial court, including the affidavit

agreement between plaintiff and David Berger, never reduced to writing, provided both for payment of costs and hourly rates and a contingency. Tr. at 25:3171–72. Under this contract plaintiff now claims $410,-550.27 including fees for 5665 and ¼ hours of attorney and non-attorney work and $64,386.52 for costs. While we do not believe we have as high a duty, in finding counsel fees under a contract, to scrutinize

> of services, is sufficiently complete to enable it to reach a fair determination as to the extent of legal services rendered and the reasonable value to be paid pursuant to the contractual provision.

44 N.J. at 452, 210 A.2d at 74. While opposing counsel in this action did file a counter-affidavit assailing the reasonableness of the attorney hours claimed, he did not object to the affidavit procedure. To be certain, however, that all parties, deeply involved during trial with the substantive issues of the case, had placed in the record all evidence they desired on the issue of attorneys' fees, we reopened the record on June 11, 1976. Again no objection was raised to the affidavit procedure, and the parties elected to stand on evidence already in the record.

Since we did not in Section I of this Opinion make factual findings on the issue of attorneys' fees, we now credit the factual representations in the various affidavits as to the hours devoted to this litigation, the hourly rates charged, and the total amount in fees and costs billed to plaintiff by David Berger. We also credit David Berger's representation that the firm devoted 67% of its time to the contract action up to December 10, 1975, when we dismissed the federal securities and common law fraud claims against the Cohen defendants, and 80–85% of its time to the contract claim thereafter. Affidavit of David Berger, ¶¶ 35–37.

a law firm's handling of a litigation as we do when awarding counsel fees out of a common fund or under statute, the *Cohen* court, through its repeated emphasis on *reasonable* counsel fees, signals us clearly that our duty under New Jersey law goes beyond checking the record for statistical evidence of the number of hours a firm worked on a case, its hourly rate, and the bill it sent its client. We have, therefore, attempted our own breakdown of the $410,-550 claimed to determine the reasonableness of the hourly rates charged and the number of hours devoted to this litigation.

David Berger testified that under his fee arrangement with plaintiff, his firm charged a flat rate of $75 an hour for attorney hours and $25 an hour for non-attorney hours. Tr. at 25:3171A. Actually, dividing attorneys' fees claimed by attorney hours claimed, the precise hourly rate works out to $72.61.[72] Multiplying the hours spent

72. While we are unwilling to discredit the representations of Coleco and David Berger, P.A., as to the total amount of plaintiff's legal expense, we are disturbed by the following inconsistency in the record. At trial David Berger testified that his firm billed Coleco a flat rate of $75 an hour for all attorney hours. In a letter to the court, dated April 14, 1976 (Doc. # 290), however, Berger states that the total billing for attorneys and non-attorneys is $346,163.75 as of March 13, 1976; he then accounts for the amount attributable to non-attorney hours. Finally, he states:

> The balance of professional services billed, $311,926.25, covers only attorneys' hours and *works out to* an hourly rate of $70.27.

(emphasis added). We are more than a little puzzled, especially in view of the testimony

by Berger's own firm by $72.61 and $25 yields a total of $284,390. Since our immediate reaction to Berger's flat rate method of billing was that it might produce excessive fees, we made an alternate computation by setting individual hourly rates for each Berger attorney based on the information on each attorney's experience and qualifications documented in David Berger's affidavit.[73] The figure we arrived at was

that the billing rate was $75 an hour for all attorneys, by this "backing into" a figure. If the firm simply charges $75 an hour for all attorneys, why does not the total billing reflect this more precisely? We, in turn, arrived at the figure of $72.61 an hour by "backing into" it after we received David Berger's affidavit of June 2, 1976 (Doc. # 293), ¶ 5 of which reads in part:

> The 4,439¼ total number of attorney hours of plaintiff's counsel devoted to this case through March 13, 1976, set forth in the Hubert affidavit was inadvertently overstated by 143⅓ hours. The correct total of attorney hours as of March 13, 1976, was 4,295¾. . . . . The total billings for professional fees including the hours of attorneys, law clerks and paralegals through March 13, 1976 are at least $346,163.75, as set forth in the Hubert Affidavit.

Thus the billing total remains constant and the hourly rate appears to be determinable only after the fact. Were we in a *Lindy* context here, we would pursue further this inconsistency.

73. We set the following individual hourly rates:

David Berger	$150
Richard Sprague	$125
Harold Berger	$100
Leonard Barrack	$65
Gerald Rodos	$55
Michael Simon	$45
Edward Rubenstone	$45
Robert Balter	$40
Other Members of Firm	$40

only $30,000 less than the figure reached when one simply multiplies the number of hours by $72.61 per hour. Considering the total amount claimed and that the fees and costs recovery arises from contract, we conclude that in this case David Berger's flat rate method of billing is not, in itself, unreasonable.

[32] We have much more difficulty with the claim of 1324 and ¼ attorney hours devoted to post-trial work including 850 and ¾ hours logged by the Washington firm of Yablonski, Both, and Edelman. We cannot but conclude that this number of hours devoted to the post-trial period is unreasonable. Accepting the representation in the Berger affidavit that these hours were spent from January 30, 1976, through March 13, 1976 (Berger Affidavit at ¶ 37), this would mean, by one standard of measure, that the post-trial work required the efforts of three attorneys working ten hours a day seven days a week for 44 days. We appreciate that plaintiff's post-trial filings, including proposed findings of fact, proposed conclusions of law, and post-trial brief, were very substantial if not elaborate, but we cannot conclude it reasonable to devote 1324 and ¼ hours to post-trial work in this case. We note especially that we believe it highly unreasonable and time-consuming to contract out the bulk of the

Cf. Entin v. Barg, 412 F.Supp. 508, 517 (E.D.Pa. 1976). *In re Penn Central Securities Litigation*, 416 F.Supp. 907, at 922 (E.D.Pa.1976).

post-trial work to another law firm unfamiliar with the case.[74] Taking our measure from the affidavit of Theodore Mann, counsel for the Cohen defendants, attesting that the firm of Mann & Ungar devoted 168 hours to the post-trial briefing, we find a reasonable number of hours for plaintiff's attorneys to have spent to be 336 hours. We double the 168 hour figure since the firm of Mann & Ungar worked only on the contract claim post-trial and had less ground to cover than did plaintiff's attorneys.[75] We note, however, that Mann & Ungar's post-trial work was of a very high quality. Since the Berger office claims 1324 and ¼ hours post-trial of which 473 and ½ were logged by Berger's own people, we will simply deny any recovery for the 850 and ¾ hours logged by the Yablonski firm and conclude that 336 hours X $72.61 or $24,397 is a reasonable fee for Berger attorney hours post-trial. We will not quarrel with the claim of 2971 and ½ hours for pre-trial and trial hours logged amounting to $215,760.61. The case was filed almost two years before it came to trial, and pre-trial discovery and motion filing were

74. Such a course of conduct is even more unreasonable when one considers that plaintiff had two attorneys present and intimately familiar with the case each day during trial, and from December 11 or 12, 1975 to late January 1976 most trial days saw three attorneys at plaintiff's counsel table.

75. In doubling the 168 hours we are admittedly being generous to plaintiff since we credit plaintiff's representation that 85% of attorney effort post-trial was devoted to the contract claim.

substantial and steady. Since we credit the representation in the Berger Affidavit that 67% of attorney and non-attorney effort up to Dec. 10, 1975, and 80–85% thereafter, was devoted to the contract claim, we will, in arriving at the total below, multiply the total of fees and costs which we have thus far allowed by 70% to arrive at the total attributable to the contract claim. We conclude, then, considering only the reasonableness of the rates charged and hours devoted to this litigation, that the following total is a reasonable one:

Attorney hours pre-trial and trial	$215,760.61
Attorney hours post-trial	24,397.00
Non-attorney hours	34,237.50
Costs	64,386.52
Preliminary Total	$338,781.63
	× .70
Final Total	$237,147.14

[33, 34] Had plaintiff's recovery for breach of contract been in the general area of the more than $1 million it claimed under its enterprise theory of liability, we would have found plaintiff entitled to recover this total of $237,147.14 in attorneys' fees and costs under ¶ 14 of the Purchase Agreement. The agreement was not an adhesion contract, and the sides, each represented by its own attorneys, were of roughly equal bargaining power. Furthermore, had plaintiff succeeded on its enterprise theory, we would necessarily have found no validity to defendants' counterclaims. Plaintiff has recovered $45,000, however, for the breach of one warranty; defendants, on the other hand, have recovered together more than

$500,000. Heeding, once again, what we believe a clear admonition from the *Cohen* court, we arrive at the admittedly drastic conclusion that plaintiff's recovery of attorneys' fees and costs in this action, even though under contract, must be limited to $15,000. This conclusion is based on our conviction that to allow a greater recovery under the circumstances of this case would do violence to that which was in the reasonable contemplation of the parties at the time of contracting and unfairly impede defendants' access to the courts.

Although the precise import of the fees and costs provision before us is reached only by reading together ¶ 14.2 and 3 of the Purchase Agreement, we feel a fair excerpting and combining of these subsections yields the following reading:

> The Stockholders jointly and severally indemnify and hold Coleco harmless against . . . .:
>
> legal fees and reasonable costs of investigation/
>
> incident to/
>
> breach . . . of any . . . warranty. . . .

This language raises the following questions: what, for present purposes, constitutes a breach and what are "legal fees and reasonable costs of investigation" "incident to" breach? In attempting to answer these questions to our satisfaction, we adopted the admittedly imperfect technique of posing to ourselves and then resolving two hypothetical cases. First, if a plaintiff claims $1 million in damages for a single

breach of contract and incurs legal expenses of $237,000 in attempting to prove that breach, yet after trial on the merits fails to prove any breach, to what amount of contractual fees and costs he is entitled? Our answer is none—based on a conclusion that the term "breach" as used in ¶ 14.2 and referred back to in ¶ 14.3 must mean a judicially established breach. If plaintiff proves no breach, then there is nothing for legal expenses to be "incident to" and therefore no legal expenses due under the contract. Second, if a plaintiff claims ten discrete breaches (breach A through breach J) of the same contract with discrete amounts of damage flowing from each breach and totaling $1 million and incurs legal expenses of $237,000 in attempting to prove the ten breaches, yet proves only breach A, a $50,000 breach, to what amount of contractual fees and costs is he entitled? We think there are two possible resolutions to this hypothetical case. If plaintiff is able to identify the portion of the $237,000 expended in legal fees and costs attributable to proving the $50,000 breach, we would award as damages under the contract any figure presented that represented a fair percentage of the recovery, perhaps even more than 50% of the recovery if the breach proved were a particularly difficult one to establish. If plaintiff could not offer any guidance, we would have to determine and award a fair percentage of the recovery as reasonable legal expense. Again the principle that we derive from this second hypothetical is that reasonable legal expense incident to breach is expense incident to

judicially determined breach only. In other words, a plaintiff both successful in proving some breaches and unsuccessful in proving others may recover only those legal expenses reasonably attributable to the judicially determined breaches. We think that the present case, although somewhat different, is not distinguishable from the case in our second hypothetical. Here, rather than suing for a series of separate breaches and proving only one, plaintiff sued for more than $1 million in damages for an alleged single but "total" breach and proved only a $50,000 partial breach. In short plaintiff gambled its case almost completely on its enterprise theory of liability, an ambitious but, upon the facts of this case some of which must have known to plaintiff early on, a risky and tenuous theory. The gamble failed. We simply do not believe it in the reasonable contemplation of the parties to the Purchase Agreement at the time of contracting that, in indemnifying Coleco against legal expense incident to breach, defendants assumed the risk that Coleco or its attorneys would view such indemnification as an invitation to "shoot for the moon" in developing and presenting legal theories with defendants' underwriting legal expenses whether or not the shot was successful. Defendants assumed the risk only of plaintiff's success, not its failure. Since plaintiff was unsuccessful and absent any guidance from plaintiff, we conclude that the reasonable legal expense incident to the breach here established is $15,000. In settling on this figure, we were influenced by two considerations. First, we noted that had plaintiff been successful on its claim, it would have recovered somewhere between $1,000,000 and $1,250,000 in damages; the $237,000, which we earlier computed as the total of reasonable fees and costs attributable to the entire contract claim, would have amounted roughly to 20–25% of the recovery. Second, we considered the ease with which plaintiff's attorneys must have uncovered the rather simple accounting errors amounting to approximately $50,000 in the April 1973 financial statement and the defendants' concession at trial of the breach which these errors represented.

[35, 36] Aside from the limitation on fees and costs we find imposed by the contractual language itself, we believe that to allow a greater recovery than we have in this action, which might well have been brought by defendants who had vindicated substantial claims here, would discourage access to the courts of parties in defendants' positions. As a matter of policy we conclude that defendants, in contracting to indemnify plaintiff against attorneys' fees and costs generated by legal disputes over defendants' breach of the Purchase Agreement, accepted only the risk that fees and costs would be generated reasonably proportional to the amount of breach damage they had caused. Otherwise there would be added an unfair pressure on defendants to settle out of court even when they had substantial defenses or counterclaims. The *Cohen* court, quoting the Court of Appeals for the District of Columbia Circuit, warns explicitly:

> In no event should the sum allowed be so large as to amount to an undue penalty for taking one's grievance to court.

To allow plaintiff's recovery of fees and costs beyond a reasonable amount based on the amount recovered for breach would constitute an "undue penalty" on defendants for bringing their claims to court. This, we infer from *Cohen,* would contravene the public policy of the State of New Jersey and would certainly shock the conscience of this court. We must limit plaintiff's damage recovery for fees and costs, therefore, to $15,000. We will not, however, set off the $350,000 Zelnick settlement against this figure of $15,000. Although the $45,000 warranty breach recovery is identical to at least part of that which might have been recovered under the securities claim against Zelnick, *Janigan v. Taylor,* 344 F.2d 781 (1st Cir.), *cert. denied,* 382 U.S. 879, 86 S.Ct. 163, 15 L.Ed.2d 120 (1965), there was no claim for attorneys' fees under the section 10(b) claim. Under these circumstances we do not think it proper to set off the settlement against defendants' liability for contractual attorneys' fees and costs.

K. *Interest*

To resolve the award of interest, we are concerned with two separate time periods: first, the period during which the parties provided for contractual interest on the balance of the unpaid purchase price, and second, the period commencing with the date on which payment of the principal and interest was due under the Purchase Agreement until the date of the judgment order.

[37, 38] Under New Jersey law, contractual interest "is the compensation fixed by the parties for the use, detention or forbearance of money or its equivalent. Since it is grounded on contract being 'part of the bargain that was struck when the loan was made,' it is recoverable as of right along with principal." *Deerhurst Estates v. Meadow Houses, Inc.*, 64 N.J.Super. 134, 154, 165 A.2d 543, 554 (1960) (citations omitted). Under the Purchase Agreement, the parties provided that $135,000 of the $500,000 non-contingent purchase price was to be paid at closing and the balance was to be paid in 3 installments with interest on the unpaid balance from May 1, 1973 at the rate of 6% per annum payable with each installment.[76] We find that the parties intended that interest accrue only until the dates set for payment of the installments under the Purchase Agreement, and we conclude that the defendants are entitled to 6% interest on the unpaid balance of the purchase price and this interest will accrue until the dates set for payment of the installments in the Purchase Agreement.

[39–41] The second time period runs from the date the installments were due under the Purchase Agreement until the

76. The Purchase Agreement provided for a non-contingent purchase price of $500,000 with $135,000 to be paid on the settlement date of May 1, 1973. The balance of the purchase price was to be paid in installments according to the following schedule: $57,500 payable on January 2, 1974; $57,500 payable on January 2, 1975; and the final $250,000 was payable on January 2, 1976. Each installment was to be paid with 6% interest from May 1, 1973.

date judgment is entered. The issue here is whether defendants are entitled to prejudgment interest. Under New Jersey law, "the rule appears to be that, unless considerations of justice and fair dealing clearly demand a different result, [prejudgment] 'interest should not be allowed where the damages are unliquidated and not capable of ascertainment by mere computation or where a serious and substantial controversy exists as to the amount due under the contract.'" *Buono Sales, Inc. v. Chrysler Motors Corp.*, 449 F.2d 715, 723 (3d Cir. 1971), *quoting Jardine Estates, Inc. v. Donna Brook Corp.*, 42 N.J.Super. 332, 341, 126 A.2d 372, 377 (App.Div. 1956). If the amount is not disputed, then prejudgment interest may be awarded to the aggrieved party notwithstanding a good faith belief or colorable claim by the breaching party that an obligation did not exist to pay the liquidated amount.[77] *See Jos. L. Muscarelle, Inc. v. Central Iron Mfg. Co.*, 379 F.2d 715 (3d Cir. 1967); *Rova Farms Resort v. Investors Insurance Co.*, 65 N.J. 474, 506, 323 A.2d 495, 512 (1974); *Kamens v. Fortugno*, 108 N.J.Super. 544, 262 A.2d 11 (Chanc.Div. 1970). It is clear that although there were numerous disputes as to legal liablility under the Purchase Agreement the amounts due the defendants under the Purchase

77. This proposition has been bolstered by the New Jersey Supreme Court's recent view that interest is not punitive, but rather should be viewed as compensation for the use of the money while it was withheld by the breaching party. *Rova Farms Resort, Inc. v. Investors Insurance Co.*, 65 N.J. 474, 516, 323 A.2d 495, 572 (1974).

Agreement were never contested. Accordingly prejudgment interest will be awarded on the balance of the unpaid purchase price. This interest will run from the dates on which the installments were payable pursuant to the Purchase Agreement until the date judgment is entered. Further we conclude that the same rationale with regard to prejudgment interest should apply to the salary payable to Mr. Rubin and the loan repayments due all defendants. The interest due on these claims also will run from the dates they were payable to defendants to the date of judgment.

[42] Also we must determine the interest rate for prejudgment interest. The New Jersey Rules of Civil Practice provide that judgments shall bear interest at the rate of 8% per annum.[78] N.J.Civ.Proc. R. 4:42–1(a). However, this rate is not mandatory, and the Court may deem it "proper to allow the contractual rate of interest to

78. It is not altogether clear whether Rule 4:42–1(a) was meant to provide the rate for prejudgment interest. The rule provides in pertinent part:

> Judgments, awards and orders for the payment of money and taxed costs shall bear interest on the amount of the award at 8% per annum *from the date of entry*, except as otherwise ordered by the court.

N.J.Civ.Proc. R. 4:42–11 (emphasis added). We conclude that the language "from the date of entry" makes it unclear whether the rule was meant to be applied to prejudgment interest. However, our holding that the parties contractual interest rate is the most appropriate interest rate makes it unnecessary for us to construe this language definitively.

continue in effect until judgment." *Mid-Jersey National Bank v. Fidelity Mortgage Investors*, 518 F.2d 640, 645 (3d Cir. 1975). Under the Purchase Agreement the parties determined that 6% was an appropriate rate of compensation for use of the money, and thus we order that all prejudgment interest be calculated at 6%.

[43] And finally we shall include prejudgment interest and contractual interest in the judgment for purposes of computing post-judgment interest. *Magee v. Ford Motor Co.*, 132 N.J. Super. 565, 334 A.2d 382 (Law Div. 1975).[79]

ORDER

NOW, December 21, 1976, pursuant to the remand from the United States Court of Appeals for the Third Circuit, IT IS ORDERED that our Order of August 9, 1976 is amended in accordance with revised paragraph K of our Opinion, to read as follows:

79. At the time of closing the Cohens and Rubin and Berman executed a side agreement (Ex. 397) by which Rubin and Berman indemnified the Cohens against damages for which defendants might become liable for breach of the financial warranty. Since we have concluded in section IIF(2) that the liability of all defendants for such breach reduces to zero when the Zelnick settlement is set off against it, we need not entertain the Cohen defendants' request that we give effect to this side agreement in computing final damage liability. In addition, since indemnity contracts are strictly construed in favor of the indemnitor, we conclude that the agreement would not reach any attorneys' fees awarded under the Purchase Agreement.

1. These judgments are entered as of August 9, 1976.

2. Judgment is entered for plaintiff and against all defendants in the amount of $15,000.00.

3. Judgment is entered for defendant Berman and against plaintiff in the amount of $160,778.93 determined as follows:

(a) Defendant Berman's share of the purchase price, $121,666.66 with $8,613.60 interest as provided in the Purchase Agreement and with $16,016.65 prejudgment interest, or a total of $146,296.91.

(b) Defendant Berman's share of the loan repayment, $13,000.00 with $1,482.02 prejudgment interest, or a total of $14,-482.02.

4. Judgment is entered for defendant Rubin and against plaintiff in the amount of $234,714.03 determined as follows:

(a) Defendant Rubin's share of the purchase price, $121,666.66 with $8,613.60 interest as provided in the Purchase Agreement and with $16,016.65 prejudgment interest, or a total of $146,296.91.

(b) Defendant Rubin's share of the loan repayment, $13,667.00 with $1,558.09 prejudgment interest, or a total of $15,-225.09.

(c) Defendant Rubin's back salary, $70,506.47 with $2,685.56 prejudgment interest, or a total of $73,192.03.

5. Judgment is entered for the Cohen defendants and against plaintiff in the amount of $164,863.86 determined as follows:

(a) The Cohen defendants' share of the purchase price, $121,666.66 with $8,613.60 interest as provided in the Purchase Agreement and with $16,016.65 prejudgment interest, or a total of $146,-296.91.

(b) The Cohen defendants' share of the loan repayment, $16,667.00 with $1,899.95 prejudgment interest, or a total of $18,566.95.

APPENDIX C

FEDERAL RULES OF CIVIL PROCEDURE

Rule 16.

PRE-TRIAL PROCEDURE; FORMULATING ISSUES

In any action, the court may in its discretion direct the attorneys for the parties to appear before it for a conference to consider

(1) The simplification of the issues;

(2) The necessity or desirability of amendments to the pleadings;

(3) The possibility of obtaining admissions of fact and of documents which will avoid unnecessary proof;

(4) The limitation of the number of expert witnesses;

(5) The advisability of a preliminary reference of issues to a master for findings to be used as evidence when the trial is to be by jury;

(6) Such other matters as may aid in the disposition of the action.

The court shall make an order which recites the action taken at the conference, the amendments allowed to the pleadings, and the agreements made by the parties as to any of the matters considered, and which limits the issues for trial to those not disposed of by admissions or agreements of counsel; and such order when entered controls the subsequent course of the action, unless modified at the trial to prevent manifest injustice. The court in its discretion may establish by rule a pre-trial calendar on which actions may be placed for consideration as above provided and may either confine the calendar to jury actions or to non-jury actions or extend it to all actions.

LOCAL RULES

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Effective January 1, 1970 to June 30, 1976

Rule 7 Status Reports and Pre-trial Conferences

(*a*) Each judge may schedule status reports and pre-trial conferences in such fashion as he deems appropriate. Attendance at such status reports and/or pre-trial conferences shall be governed by Local Rule 16(*b*) and (*c*). Unless the judge orders otherwise, a pre-trial memorandum shall be filed by the plaintiff not later than 90 days after the commencement of the action and a pre-trial memorandum shall be filed by the defandant not later than 30 days after the filing of the plaintiff's pre-trial memorandum. In all actions pending as of January 1, 1970, plaintiff's pre-trial memorandum shall be filed not later than April 1, 1970 and the defendant's pre-trial memorandum shall be filed by May 1, 1970. Unless otherwise determined by the judge such pre-trial memorandum shall contain the following:

(1) A brief summary statement of both the facts of the case and counsel's contentions as to the liability of defendant. In personal injury cases involving motor vehicles, a small, informal, schematic diagram should be included to show the names and directions of streets involved, traffic flow, the paths of the cars or pedestrians involved, and the point of impact.

(2) A brief description of the damages claimed and the basis thereof. In personal injury cases, as to each injured plaintiff there should be included a brief summary statement of:

A. the principal injuries sustained;
B. hospitalization and convalescence;
C. present disability;
D. a summary of the special monetary damages, to include a detailed statement of loss of earnings to date and a detailed statement as to the loss from future impairment of earning capacity, total medical expenses, property damage, and miscellaneous expenses;

E. estimated value of pain, suffering, etc.
F. The names and addresses of all witnesses (except rebuttal) whom the plaintiff expects to call to testify at the time of trial. Failure to call at trial any listed witness shall not be a proper subject of jury argument unless justified by the record of the case exclusive of the pre-trial memorandum.
G. Designation by counsel of any special comments regarding amendments to the pleadings or legal issues that might arise at trial.
H. Stipulations, including designation of any documents, for which plaintiff's counsel seeks agreement or admissibility at the time of trial.
I. An estimate of the number of trial days required for the case.

Defendant's counsel in his pre-trial memorandum shall note, with the same degree of particularity as required by plaintiff, under correspondingly lettered paragraphs, significant comments indicating areas of agreement or disagreement regarding the material in plaintiff's memorandum. Where there is disagreement with respect to items in paragraphs A, B, C, D, or E, counsel should briefly set forth his client's contentions or position on such matters. Defendant's counsel shall also include in his pre-trial memorandum the same material pertaining to defendant's case as required of plaintiff in paragraphs F, G, H and I.

(*b*) Except for witnesses called on rebuttal or surrebuttal, a witness neither (1) named in any pretrial memorandum or supplements thereto of any party, nor (2) authorized by the court in order to prevent manifest injustice, may not testify at the trial if timely objection is made by opposing counsel.

(*c*) The judge to whom the case is assigned may require more or less elaborate pre-trial memoranda and may publish his own standing order with respect to the manner in which he intends to hold pre-trial conferences and his requirements of counsel in respect of pre-trial procedures.

LOCAL RULES

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Effective July 1, 1976 to Present, As Amended

Rule 7 Pretrial Procedure

(a) **Introduction**

This Local Rule is intended to set forth the basic pretrial procedure for use by the Judges of the United States District Court, Eastern District of Pennsylvania, and where applicable, by each United States Magistrate, in all civil proceedings brought before the Court. The judge to whom a case is assigned may require more or less elaborate pretrial information and documents during pretrial proceedings, but it is expected that each judge will use some or all of the various provisions included in this rule in formulating pretrial orders and conducting pretrial proceedings. It is also contemplated that variations and substitutions to the procedure will be necessary on occasion by reason of the application of special rules, such as those for multidistrict and complex litigation, admiralty, and the like. Except for these and similarly compelling reasons, however, this rule will govern in the interest of uniformity.

This rule envisions six basic pretrial steps:

(1) A preliminary pretrial conference, as provided in Section (*b*).

(2) The submission of pretrial memoranda prepared and submitted in accordance with the instructions contained in Section (*c*).

(3) Such interim status calls or reports as the judge may direct.

(4) Such interim pretrial or settlement conferences as the judge may direct.

(5) The submission of a final pretrial order, prepared in accordance with the instructions contained in Section (*e*), and

(6) A final pretrial conference as discussed in Section (*d*).

The judge may determine that one or more of these six basic steps will not be required. In such event, appropriate notice shall be given to counsel.

Each judge may schedule status calls or reports and pretrial or settlement conferences in the manner he deems appropriate. Attendance at such proceedings shall be governed by Local Rule 16(*b*) and (*c*).

(b) **Preliminary Pretrial Conference**

Within forty-five days following the filing of the complaint, the judge (or a United States Magistrate) shall hold a preliminary pretrial conference. The purpose of such conference may be to:

(1) Review the status of the pleadings;

(2) Formulate a discovery completion schedule;

(3) Set dates for the exchange of exhibits and the qualifications of experts;

(4) Set dates for the filing of pretrial memoranda prepared in accordance with the provisions of Section (*c*) of this order;

(5) Set dates for any further pretrial conferences;

(6) Set date for trial;

(7) Explore the possibilities of settlement;

(8) Consider such other matters as may be relevant.

(c) **Instructions for Preparation of Pretrial Memoranda**

Unless the judge (or a United States Magistrate) orders otherwise, a pretrial memorandum shall be filed by plaintiff within thirty days (or such longer period as directed by the judge) following the preliminary conference, and a pretrial memorandum shall be filed by defendant and third-party defendant within fifteen days of the filing of plaintiff's pretrial memorandum, or in respect to the third-party defendant within fifteen days of the filing of its answer. Provided, however, that if the judge does not hold a preliminary pre-

trial conference that the pretrial memorandum of plaintiff shall be filed within ninety days after commencement of the action, and the pretrial memorandum of all other parties shall be filed within thirty days thereafter.

The pretrial memorandum shall contain the following:

(1) A brief statement of the nature of the action and the basis on which the jurisdiction of the court is invoked.

(2) A brief statement of the facts as contended by the party preparing the pretrial memorandum.

(3) A list of each item of monetary damages claimed, including a summary of the special monetary damages, to include a detailed statement of loss of earnings to date and a detailed statement as to the loss from future impairment of earning capacity, total medical expenses, property damages, and miscellaneous expenses. If other than monetary damages are claimed, the exact form of relief sought with precise designations as to persons, places, and things to be included in any order providing relief.

(4) Under separate headings for liability and damages, the names and addresses of all witnesses that the party preparing the memorandum expects to call at trial.

(5) A schedule of all exhibits to be offered at trial.

(6) Special comments regarding the legal issues or any amendments to the pleadings that are not otherwise set forth in the pretrial memorandum.

(7) An estimate of the number of trial days required.

(d) **Final Pretrial Conference**

A final pretrial conference shall be scheduled by the judge a short time prior to the date it is estimated that the case will be reached for trial. This section (Section (*d*)) deals with that conference. The next section (Section (*e*)) deals with the preparation of a final pretrial order, which will be considered at the final pretrial conference, and which will govern the conduct of the trial.

Trial counsel shall attend the final pretrial conference.

At the final pretrial conference, the judge will consider the simplification of the issues, the necessity or desirability

of amendments to the pleadings, the separation of issues, the desirability of an impartial medical examination, the limitation of the number of expert witnesses, the probable length of the trial, the desirability of trial briefs, evidentiary questions, the submission of points for charge, and such other matters as may aid in the trial or other disposition of the action. The prospects of settlement will be explored and therefore, counsel who attend the pretrial conference shall be authorized to enter into a settlement agreement or shall have available by telephone such persons who are empowered to enter into a settlement agreement.

(e) **Instructions for Preparation of Proposed Pretrial Order**

The proposed pretrial order shall consist of one document signed by all counsel, reflecting the efforts of all counsel. It is the obligation of plaintiff's counsel to initiate the procedures for its preparation, to assemble, and to submit the proposed pretrial order to the judge.

Counsel may find it advantageous to prepare the proposed pretrial order jointly in one conference, or each attorney may prepare his section which will then be circulated with other counsel for review and approval. No explicit directions covering the mechanics of preparation are included in these instructions. However, after each counsel has submitted his respective proposed pretrial order suggestions to other counsel, all counsel *must* have a conference to attempt to reconcile any matters on which there is disagreement. Counsel are expected to make a diligent effort to prepare a proposed pretrial order in which will be noted all of the issues on which the parties are in agreement and all of those issues on which they disagree. The proposed pretrial order shall be submitted by counsel for the plaintiff at chambers at least three days prior to the scheduled final pretrial conference, unless another date is specified by the judge.

The proposed pretrial order, if accepted by the judge, will become a final pretrial order and shall govern the conduct of the trial and shall supersede all prior pleadings in the case. Amendments will be allowed only in exceptional circumstances to prevent manifest injustice.

After the proposed pretrial order has been designated as the final pretrial order, the case will be considered ready for trial.

(f) **Form of Proposed Pretrial Order**

The proposed pretrial order shall be in the following form:

(CAPTION)

(1) *Jurisdiction.* A statement as to the nature of the action and the cases under which the jurisdiction of the court is invoked.

(2) *Facts.* A comprehensive written stipulation of all uncontested facts in such form that it can be read to the jury as the first evidence at trial.

(A) These facts should include all matters capable of ascertainment, such as ownership, agency, dimensions, physical characteristics, weather conditions, road surfaces, etc. Approximations and estimates which are satisfactory to counsel will be accepted by the judge.

(B) No facts should be denied unless opposing counsel expects to present contrary evidence on the point at trial, or genuinely challenges the fact on credibility grounds.

(C) The facts relating to liability and to damages are to be separately stated.

(D) The parties shall reach agreement on uncontested facts even though relevancy is disputed; if such facts are ruled admissible, they need not be proved.

(E) The parties shall also set forth their respective statements as to the facts which are in dispute, separating those referring to liability from those referring to damages.

(3) *Damages or Other Relief.* A statement of damages claimed or relief sought.

(A) A party seeking damages shall list each item claimed under a separate descriptive heading (personal injury, wrongful death, survival, loss of profits, loss of wages, deprivation of civil rights, false imprisonment, libel, slander, property damage, pain, suffering, past and future medical expense, balance due under a contract, performance due under a contract, interest, etc.), shall provide a detailed description of each item, and state the amount of damages claimed.

(B) A party seeking relief other than damages shall list under separate paragraphs the exact form of relief sought with precise designations of the persons, parties, places, and things expected to be included in any order providing relief.

(4) *Legal Issues.* Under separate paragraphs, each legal issue that must be decided and the principal constitutional, statutory, regulatory, and decisional authorities relied upon.

(5) *Witnesses.* Under separate headings, and under separate headings for liability and damages, the names and addresses of all witnesses whom the plaintiff, defendant, and third-parties actually intend to call at trial.

(A) Witnesses shall be listed in the order they will be called. Each witness shall be identified and there shall be a brief statement of the evidence which the witness will give.

(B) A detailed summary of the qualifications of each expert witness shall be submitted. This summary shall be in such form that it can be read to the jury when the expert takes the stand to testify.

(C) Only those witnesses listed will be permitted to testify at trial, except to prevent manifest injustice.

(D) Failure to call at trial any listed witness shall not be a proper subject of jury argument unless justified by the record of the case exclusive of pre-trial memoranda or the pre-trial order.

(6) *Exhibits.* A schedule of all exhibits to be offered in evidence at trial, together with a statement of those agreed to be admissible and the grounds for objection to any not so agreed upon.

(A) The exhibits shall be serially numbered, without any designation as to whether they are being offered by plaintiff or defendant. The exhibits shall be physically marked before trial in accordance with the schedule.

(B) Where testimony is expected to be offered as to a geographical location, building, structure, waterway, highway, road, walkway, or parcel of real estate, plaintiff shall furnish an exhibit in such form that it can be used in the courtroom as an aid to oral testimony.

(i) Except in those cases where the issues require the use of exact scale, the exhibit may be a simple single-line, hand-drawn sketch.

(ii) In most instances, it will not be necessary that the exhibit be to scale or contain other than reasonably accurate features of the geographical characteristics involved.

(iii) If of adequate size and clarity, this exhibit may be an existing drawing, plan, or blueprint.

(C) Except for unusual circumstances, it is expected that the authenticity or genuineness of all exhibits, including non-documentary items, documents, photographs and data from business records from sources other than parties to the litigation, will routinely be stipulated to and will be received in evidence if relevant. Counsel likewise are expected to agree upon the use of accurate extracts from or summaries of such records. Life expectancy tables, actuary tables, and other similar statistical and tabular data routinely and regularly used in litigation in the Federal Courts should also normally be stipulated.

(D) At trial counsel shall furnish a copy of each exhibit to the judge.

(7) *Legal Issues and Pleadings.* Special comments regarding the legal issues or any amendments to the pleadings not otherwise set forth.

(8) *Trial Time.* An estimate of the number of trial days required, separately stated for liability and damages.

(9) *Discovery Evidence and Trial Depositions.* Each discovery item and trial deposition to be offered into evidence.

(A) Where the videotape or deposition of a witness is to be offered in evidence, counsel shall review it so that there can be eliminated irrelevancies. side comments, resolved objections, and other matters not necessary for consideration by the trier of fact. Counsel shall designate by page the specific portions of deposition testimony and by number the interrogatories which shall be offered in evidence at the trial.

(B) Depositions and interrogatories to be used for cross-examination or impeachment need not be listed or purged.

(10) *Miscellaneous.* Unless otherwise ordered, all issues relating to liability shall be severed and tried to verdict; thereafter, if necessary, a separate trial shall be had on the issues of damages.

(g) **Miscellaneous Instructions Pertaining to Trial**

In all non-jury trials, requests for findings of fact and conclusions of law shall be filed in duplicate at chambers prior to the commencement of trial. Such requests shall be filed when the judge may direct, but in the absence of any specific direction, not later than the day trial commences.

In all jury trials, requests for instructions to the jury, together with citations to legal authorities in support thereof, proposed voir dire questions, and jury interrogatories, shall be submitted in duplicate at chambers. Such materials shall be filed when the judge may direct but in

the absence of any specific direction, not later than the day when trial commences.

Except upon stipulation by affected counsel or by order of the judge, no statement contained in preliminary pretrial memoranda or the pretrial order shall be made the subject of comment to the jury by any party at the trial of the case.

Any counsel needing special equipment, device, personnel, or court room arrangements, shall be responsible for assuring that such items are available at the time they are needed. Personnel assigned to the judge shall not be expected or depended upon to provide service for any party or counsel in the absence of a notation contained in the final pretrial order. Arrangements for daily copy shall be made at least two weeks in advance of trial with the judge's court reporter.

Trial shall not be continued because of the unavailability of a witness, particularly an expert witness. If the witness's ability to appear is at all doubtful, counsel shall consider taking the trial deposition of such witness by videotape.

Note. Rule 7 amended June 17, 1976, effective July 1, 1976; further amended August 9, 1976, effective immediately. It should be noted that this Rule is not a command that each judge utilize it in its entirety. Its use by some judges may be minimal. It is only designed to achieve as much uniformity as possible in the content of those portions which are used by individual judges.

Supreme Court, U. S.
FILED
JUL 3 1978
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1977.

No. 77-1725.

COLECO INDUSTRIES, INC.,

Petitioner,

v.

ABE BERMAN, JOSEPH RUBIN, IRVING COHEN, LEWIS M. COHEN, FREDERICK COHEN, ZELNICK, SOBELMAN & COMPANY,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

THEODORE R. MANN,
MANN AND UNGAR,
Professional Association,
1711 Rittenhouse Square,
Philadelphia, Pa. 19103
Attorney for Irving Cohen, Lewis Cohen and Frederick Cohen.

MARTIN RESNICK,
E. HARRIS BAUM,
ZARWIN, BAUM, ARANGIO & SOMERSON,
715 Widener Building,
Philadelphia, Pa. 19107
Attorney for Abe Berman.

DANIEL B. PIERSON, V,
PIERSON, JONES & NELSON,
1600 PNB Building,
Philadelphia, Pa. 19107
Attorney for Joseph Rubin.

International Printing Co., 711 So. 50th St., Phila., Pa. 19143 — Tel. (215) 727-8711

INDEX.

	Page
QUESTION PRESENTED	1
STATEMENT OF THE CASE	2
ARGUMENT	5
I. Coleco's Attempt to Surprise Defendants by the Introduction of Testimony Based on a Statistical Sampling of 1972 Invoices Was Properly Prevented by the District Court	5
II. The Decision by the Appellate Court Is Not Inconsistent With Other Decisions and Does Not Call for an Exercise of This Court's Supervisory Powers	7
CONCLUSION	9

TABLE OF CITATIONS.

Cases:	Page
Adickes v. S. H. Kress & Co., 409 F. 2d 121 (2d Cir. 1968) ..	8
Clark v. Pennsylvania Ry. Co., 328 F. 2d 591 (3d Cir. 1964)	8
Dudley v. South Jersey Metal, Inc., 555 F. 2d 96 (3d Cir. 1977)	7
Peter Eckrich & Sons, Inc. v. Selected Meat Co., 512 F. 2d 1158 (7th Cir. 1975)	7
Ely v. Reading Co., 424 F. 2d 758 (3d Cir. 1970)	8
Kozar v. Chesapeake & Ohio Ry. Co., 320 F. Supp. 335 (W. D. Mich. 1970)	8
McCargo v. Hedrick, 545 F. 2d 393 (4th Cir. 1976)	8
Meyers v. Pennypack Woods Home Ownership Ass'n., 559 F. 2d 894 (3d Cir. 1977)	7, 9
Thompson v. Calmar Steamship Corp., 331 F. 2d 657 (3d Cir. 1964)	8
Statutes and Rules:	
Federal Rules of Civil Procedure, Rule 16	5
Miscellaneous Authorities:	
Manual for Complex Litigation (Moore's ed.):	
§ 2.70	7
§ 3.50	6
§ 2.711	7
§ 2.713	7

QUESTION PRESENTED.

In answers to interrogatories and in its pretrial memorandum filed a month before trial, a plaintiff states that it will rely on certain data to prove an allegation. A week before trial it determines that such data is irrelevant. It then prepares a sample study of altogether different data to prove the allegation, with no notice to defendants. In the third week of a jury trial it offers testimony based on such study. Does a district court abuse its discretion in precluding such testimony on the ground that its admission would be highly prejudicial to defendants?

STATEMENT OF THE CASE.

On June 4, 1973 Coleco Industries, Inc. (Coleco) acquired the shares of stock of a new competitor in the swimming pool business, Royal All-Aluminum Swimming Pool Corporation (Royal).

In December, 1973 Coleco, which had not yet paid the full purchase price, instituted this litigation claiming several million dollars in damages for alleged violations of Rule 10(b)-5, common law fraud, and breaches of a variety of warranties. Royal's shareholders counterclaimed for the balance of the purchase price. Cross-claims were asserted, *inter alia,* against Royal's accountants.

The petition raises only one issue in what was a very complex, multi-issue trial. The Royal shareholders warranted the correctness of Royal's unaudited financial for its last quarter, which ended April 30, 1973.[1] Coleco alleged a breach of that financial warranty, claiming that in respect of 407 pools manufactured by Royal in that last quarter, the manufacturing costs exceeded by $80,272 the cost revealed in the financial.

Defendants sought to determine the basis of this claim. In Answers to Interrogatories, again in its affidavit attached to its Motion for Partial Summary Judgment filed a month before trial, and again in its Pretrial Memorandum filed two weeks before trial, Coleco stated that it intended to prove the real cost of manufacturing those pools from Royal's invoices for the purchase of materials in the period March through June, 1973. The details of Coleco's pretrial assertions are set out below.[2]

1. The financial was prepared by Royal's accountants and Coleco's in-house accountant during the negotiations which preceded the purchase. Immediately before trial Royal's accountants settled with Coleco for $350,000.

2. Defendants served Interrogatories to determine the basis of the claim. Coleco responded that it had costed out those pools

A week before trial, oral argument was held on Coleco's Motion for Partial Summary Judgment. The undersigned argued that 1973 invoices were irrelevant to the allegation since Royal's 1973 pools were assembled from materials purchased a full year earlier.[3] The Motion for Partial Summary Judgment was denied.

Fifteen days after the jury trial began, Coleco produced its in-house accountant, Hubert, as a witness. The undersigned objected (Tr. 1090 et seq.) that the proferred

2. (Cont'd.)

"using May and June, 1973 invoice prices" and determined that the "costs per pool were significantly higher than the costs which were employed to reduce the inventory as of the April 30, 1973 statement . . ." (Dock. #31, 46)

A month before trial Coleco filed a Motion for Partial Summary Judgment. In its supporting Memorandum (Dock. #155, at pp. 52-54) Coleco stated that in 1973 it prepared revised cost sheets for the Royal pools, using "purchase invoices for July and August of 1973" and that "primarily on the basis of these revised costs" it "initiated this litigation . . ." It further stated that in order to verify its findings, it reviewed March-April, 1973 purchase invoices, and that its in-house accountant, "Mr. Hubert employed March-April, 1973 . . . data so that a determination could be made as to the material costs of the . . . pools at or about the time of preparation of the April 30, 1973 Royal financial statement." Attached to its Motion was Hubert's affidavit (Dock. #157, 173) setting forth in detail its undercosting claim, all of it based on purchase invoices from March, 1973 forward.

Two weeks before trial Coleco filed its Pretrial Memorandum (Dock. #169) stating that it intended to prove that "the physical inventory in August, 1973 was counted by Coleco and Royal personnel and was priced by Coleco and Royal personnel. Subsequent to the August, 1973 physical inventory, cost sheets on the entire Royal pool line were prepared *on the basis of May-June, 1973 invoices prices.*" In the "Witness" section of its Pretrial Memorandum Coleco listed Hubert, and stated that he would testify about "the costing review carried out by Coleco and Royal in August and September, 1973." Other "financial" witnesses were listed but the description of their testimony bore no relation whatever to an examination of any pre-March, 1973 purchase invoices.

3. The irrelevancy of Coleco's proofs were made even more obvious by its vice-president's statement that by April, 1973 there had been "drastic material cost increases". (86a; Ex. U-304)

testimony was expert testimony and Hubert had not been listed as an expert witness in Coleco's pretrial memo. By agreement (Tr. 1135-1136), the court heard Hubert's testimony outside the presence of the jury. The court then decided (Tr. 1178-1182) to permit Hubert to testify as an expert, but that given the nature of his proposed testimony, defendants should have an opportunity to depose him. The court recessed trial so that Hubert could be deposed that night. It was during that deposition—on the evening of the fifteenth day of trial—that defendant learned for the first time that one week before the trial began, with notice to no one, Coleco hired a Philadelphia accounting firm to "sample test" Royal's *1972* invoices in order to produce testimony that 1972 costs did not differ substantially from 1973 costs. The accounting firm spent three weeks doing so.

The next day, Hubert began to testify about 1972 invoices. The undersigned objected that testimony concerning 1972 invoices should be precluded because defendants had learned of the sample testing of 1972 invoices only the night before; the Manual for Complex Litigation recommends that notice of sample tests be given far in advance of trial in order to protect litigants against unreliable evidence; and since thousands of invoices were involved, it would be highly prejudicial to allow in such testimony which defendants could not adequately cross-examine and the accuracy of which they could not verify. (Tr. 1239-1240). The court agreed and ruled that under "all of the circumstances" use of 1972 invoices would be a surprise . . . and would be highly prejudicial to defendants." (Tr. 1256-1258).

ARGUMENT.

I. Coleco's Attempt to Surprise Defendants by the Introduction of Testimony Based on a Statistical Sampling of 1972 Invoices Was Properly Prevented by the District Court.

This case does not involve, as Coleco would have the Court believe, an overly rigid application of a pretrial procedure adopted pursuant to F. R. C. P. 16. The District Court displayed extraordinary flexibility and caution first by hearing Hubert's testimony outside the jury's presence so that the problem could be intelligently assessed, and then by recessing trial to permit the taking of his deposition so that he could testify as an expert even though he had not been designated as such. All of this judicial caution prevented what surely would have been prejudicial error—the surprise introduction of a secretly prepared sample study which defendants could not have tested adequately through cross-examination because they had been misled into believing that Coleco was relying on other evidence entirely.

Coleco's pretrial memo, in which it stated that Royal's invoices for the period March through June, 1973, would be used to prove its theory that inventory was overvalued, was only one of the factors underlying the trial court's decision. For Coleco had also given defendants the same information in answers to interrogatories, and in a memorandum and affidavit in support of its motion for summary judgment. Coleco never amended its answers to interrogatories; it never moved to amend its pretrial statement; nor in any other way did it give the defendants any advance notice that it intended to rely not on 1973 invoices, but on a sample study of 1972 invoices.

One week before trial Coleco realized that its proofs did not support its allegations, when the undersigned, responding to the case as Coleco had stated it, pointed out that the pools in question were made of materials purchased a year earlier. To remedy that defect, Coleco had several choices. It might have requested a continuance of the trial to give its counsel time to compile other data. It might have notified defendants and the court that it was hiring accountants to do a sample study of the appropriate invoices. It could have invited defendants to participate in that study or given them a chance to conduct a parallel study. It could and should have sought leave to amend its pretrial statement through a motion that would have given defendants some minimal notice of its intention to rely on different evidence.

Against this background, the ruling by the trial judge did not turn the trial "into a game of skill" in which "one misstep by counsel [was] decisive to the outcome." (Petition 14). Coleco made more than a misstep. It misled the parties and the court. It, not the court, attempted to turn the trial into a "game," a game of surprise.

We emphasize, as did the court (T.. 1257), the special prejudice which results when a litigant is surprised with the type of sampling evidence involved here. As stated in the Manual for Complex Litigation, § 3.50 p. 131 (Moore's ed.)

> "within this area [sample studies] the protection against unreliable evidence afforded by the traditional orthodox hearsay rule can be supplied only by full disclosure to the adverse party in pretrial proceedings."

The Manual recommends that the data underlying a sample study, the method of interpreting the study, and the

conclusions reached be made available to opposing parties *far in advance* of trial. Manual, § 2.713, 2.70, 2.711. This unusual recommendation reflects the well founded concern that without full opportunity to test its assumptions, a sample study may produce a skewed, false result.

Thus the court properly excluded the testimony in question. But even if the evidence had come in, and even if it had been believed, it would not have changed the result. Royal's accountants paid Coleco $350,000 in settlement of the case on the day before the trial began. That amount more than compensated Coleco for any conceivable loss it might have sustained (105a-106a). Furthermore, the District Court found "that even a $130,000 discrepancy [as opposed to the $49,992 error which the accountants admitted (82a)] with the reduction in profitability which it implies" neither "rendered Royal valueless [n]or caused Royal's failure." (88a, n. 48).

II. The Decision by the Appellate Court Is Not Inconsistent With Other Decisions and Does Not Call for an Exercise of This Court's Supervisory Powers.

Each of the cases which Coleco cites as in conflict with the decision of the Third Circuit is in fact distinguishable.

The court (13a, n. 14) properly distinguished its previous decisions in *Meyers v. Pennypack Woods Home Ownership Association*, 559 F. 2d 894 (3d Cir. 1977) and *Dudley v. South Jersey Metal, Inc.*, 555 F. 2d 96 (3d Cir. 1977). (Coleco Pet. 9).

In *Peter Eckrich & Sons, Inc. v. Selected Meat Co.*, 512 F. 2d 1158 (7th Cir. 1975) (Coleco Pet. 15), the trial court's refusal to hear plaintiff's expert witnesses was reversed because, although plaintiff failed to comply with a pretrial order requiring listing of expert witnesses, plain-

tiff had repeatedly notified both the parties and the court of its intention to call them. Unlike this case, there was no prejudice or surprise.

Similarly, in *McCargo v. Hedrick*, 545 F. 2d 393 (4th Cir. 1976) (Coleco Pet. 15), no prejudice or surprise resulted from plaintiff's failure to comply with an unduly burdensome local rule that required the filing of a detailed pretrial memo. The pretrial dismissal for non-compliance was properly reversed because the rule itself had become an obstacle to the administration of justice. Here Coleco's evidence was excluded because it was prejudicial to defendants, not because it violated some technical or unduly burdensome local rule.

The decision below does not depart from the sound principle that *if the opposing party has not been prejudiced by the delay*, relief will be granted to a party who makes a good faith effort to bring before the court at the *earliest possible time* any questions or problems ordinarily handled at pretrial. *Kozar v. Chesapeake & Ohio Railway Co.*, 320 F. Supp. 335, 374, 377 (W. D. Mich. 1970), affirmed in part, vacated in part, 449 F. 2d 1238 (6th Cir. 1971). Clearly, Coleco was not entitled to avail itself of this principle. See *Thompson v. Calmar Steamship Corp.*, 331 F. 2d 657, 662 (3d Cir.), cert. denied, 379 U. S. 413 (1964) (surprise testimony of witness as a fact witness properly excluded when pretrial memo and answers to interrogatories indicated witness was an expert witness); *Adickes v. S. H. Kress & Co.*, 409 F. 2d 121, 124 (2d Cir. 1968), rev'd. on other grounds 398 U. S. 144 (1970) (exclusion of expert testimony was within trial court's discretion where opposing party was notified only one day before trial that expert would be called); See generally *Clark v. Pennsylvania Ry. Co.*, 328 F. 2d 591, 594-595 (3d Cir. 1964); *Ely v. Reading Co.*, 424 F. 2d 758 (3d Cir. 1970) (district court's rulings in enforcing policies behind pre-

trial procedures should be reversed only for clear abuse of discretion).

Thus this is not a case calling for the exercise by this Court of its supervisory powers over local procedures. Where prejudice to an adverse party constitutes the basis for an exclusionary ruling, the lower courts are already working within appropriate guidelines that require no elaboration by this Court. See *Meyers v. Pennypack Woods Home Owership Association*, 559 F. 2d at 904-905.

CONCLUSION.

The Petition for Certiorari should be denied.

Respectfully submitted,

THEODORE R. MANN,
MANN AND UNGAR,
Professional Association,
1711 Rittenhouse Square,
Philadelphia, Pa. 19103
Attorney for Irvin Cohen, Lewis Cohen and Frederick Cohen.

MARTIN RESNICK,
E. HARRIS BAUM,
ZARWIN, BAUM, ARANGIO & SOMERSON,
715 Widener Building,
Philadelphia, Pa. 19107
Attorneys for Abe Berman.

DANIEL B. PIERSON, V,
PIERSON, JONES & NELSON,
1600 PNB Building,
Philadelphia, Pa. 19107
Attorney for Joseph Rubin.

Supreme Court, U. S.
FILED
AUG 2 1978
JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1977

No. 77-1725

COLECO INDUSTRIES, INC.,

Petitioner,

ABE BERMAN, JOSEPH RUBIN, IRVING COHEN, LEWIS M. COHEN, FREDERICK COHEN, ZELNICK, SOBELMAN & COMPANY,

Respondents.

REPLY MEMORANDUM OF COLECO INDUSTRIES, INC.

JOSEPH A. YABLONSKI
DANIEL B. EDELMAN

Yablonski, Both & Edelman
1150 Connecticut Avenue, NW
Suite 500
Washington, DC 20036

Attorneys for Coleco Industries, Inc.

THE CASILLAS PRESS, INC.–1717 K Street N. W.–Washington, D. C.–223-1220

IN THE

Supreme Court of the United States

October Term, 1977

No. 77-1725

COLECO INDUSTRIES, INC.,

Petitioner,

ABE BERMAN, JOSEPH RUBIN, IRVING COHEN, LEWIS M. COHEN, FREDERICK COHEN, ZELNICK, SOBELMAN & COMPANY,

Respondents.

REPLY MEMORANDUM OF COLECO INDUSTRIES, INC.

In their Opposition to Coleco's Petition, Respondents make several assertions of fact and law which, though superficially appealing, find no support in this record or in the decisions below. The Court of Appeals' decision — upholding a ruling which thwarted Coleco from presentation of evidence critical both to claims and its defense to Respondents' counterclaims — is contrary to the decisions of other appellate courts and to the proper function of pretrial. A short reply memorandum may be helpful to assure that the Court's focus is concentrated on the issue presented.

It should be noted at the outset that Respondents do not dispute these incontrovertible record events:

1. No pretrial order — such as is contemplated by Rule 16, F.R.C.P. — limiting the issues for trial was ever entered in this case.

2. The District Judge required the parties to file elaborate pretrial memoranda listing their respective factual and legal contentions; and Coleco filed such a memorandum, 157 pages in length and containing 715 paragraphs.

3. While Coleco's Pretrial Memorandum stated Coleco would prove that Respondents' financial statement understated the cost of pools sold by $80,000, it did not specify *how* it would prove this undercosting error. Specifically, Coleco's Memorandum in no way stated that Coleco would rely exclusively on 1973 invoices as opposed to relying on 1972 invoice or invoices for both years.

4. The Court excluded evidence — regarding 1972 invoices — because Coleco had failed to seek amendment of its own Pretrial Memorandum.[1]

[1] While Coleco's summary judgment motion was predicated solely on the 1973 invoices for proof of the undercosting error, its Pretrial Memorandum in no way indicated that proof at trial would be so limited. It was only at the eve-of-trial argument on the summary judgment motion that Respondents challenged Coleco's reliance on the 1973 invoices thereby suggesting the need for proof that the 1972 invoices were no different. Respondents still fail to identify any statement in Coleco's Pretrial Memorandum which would need amendment in order to make way for such proof (See Petition, pp. 7-8). While they set out a catalogue lumping together Coleco's "pretrial assertions" (Opposition, pp. 2-3), it is only in Coleco's summary judgment motion that they can point to exclusive reliance on 1973 invoices. To the extent their catalogue refers to statements in the Pretrial Memorandum pertaining to 1973, those statements do not suggest *exclusive reliance on 1973 invoices* but rather refer to *particular events* which occurred in 1973 — i.e., the taking of an inventory in August 1973 and a subsequent analysis of inventory costs. Coleco's comparison of 1973 and 1972 invoices obviously called for no change in the Memorandum's description of these events. While Respondents assert that Coleco's Pretrial Memorandum committed it to sole reliance on 1973 invoices (Opposition, p. 6), their own references to the Memorandum establish that this was not the case.

5. As a direct consequence of its preclusion ruling, the Court rejected Coleco's $80,000 contract claim and its defense to the $400,000 counterclaim of Respondents.

The clear and unmistakable conclusion to be drawn from the foregoing is that Coleco was substantially — indeed, irreparably — damaged because it sought to offer evidence in the midst of a lengthy and complex trial which was not expressly referred to in its massive pretrial memorandum. Coleco's inability to pre-try its case on paper exactly as it sought to try it in court was not a proper basis for excluding the proferred evidence. Rather, as described in Coleco's opening brief, the "requirement of a kind of pre-pretrial special pleading" is, as Judge Clark stated, "at war with the basic concept of F.R. 16. . . ." Clark, *Seminar on Procedures for Effective Judicial Administration*, 29 F.R.D. 191, 458-59 (1961). Moreover, making lawyers try a case "twice" — once on paper and once in court — has been identified by Chief Justice Burger as the principal defect in the pretrial process. Burger, *Address to the National Conference on the Causes of Popular Dissatisfaction with the Administration of Justice*, 70 F.R.D. 79, 95-96 (1976).

Plainly, the decision below — authorizing preclusion of evidence not specified in a party's pretrial memorandum — cannot be minimized or justified on other grounds;[2] nor can the decision be reconciled with the purpose of Rule 16 or the decisions of the Fourth and Seventh Circuits[3] which abhor the growing abuses of the pretrial process.

[2] Respondents seek to justify the District Court's exclusion of evidence on other grounds, namely, that the evidence constituted a "sample". The evidence Coleco sought to adduce was not a sample, but an item-by-item comparison of materials purchased in 1972 and 1973. Contrary to Respondents' assertions, they would not have been prejudiced in any way by the admission of evidence regarding 1972 costs. Respondents owned and operated the business during 1972 and had access to the 1972 invoices months in advance of the trial and throughout the trial itself (Tr. 1254). Had Coleco's testimony been admitted, Respondents could easily have made their own comparison of 1972 and 1973 costs.

[3] *McCargo* v. *Hedrick*, 545 F.2d 393 (C.A. 4, 1973); *Peter Eckrich & Sons, Inc.* v. *Selected Meat Co.*, 512 F.2d 1158 (C.A. 7, 1975).

CONCLUSION

For the reasons stated herein and in the Petition, certiorari should be granted to resolve the Circuit conflict and to restore Rule 16 to the purposes envisioned by this Court and its framers when it was initially adopted.

Respectfully submitted,

JOSEPH A. YABLONSKI
DANIEL B. EDELMAN

Yablonski, Both and Edelman
1150 Connecticut Avenue, N.W.
Suite 500
Washington, D.C. 20036